NATURAL RESOURCES COMMISSION
Information Bulletin #20
This information bulletin supersedes Information Bulletin #20 printed at 26 IR 3439.
(First Amendment)
Ratemaking Process for Resorts and Marinas under Lease with the Department of Natural Resources

1. Purpose

The purpose of this information bulletin is to implement an informal process for the administrative review of ratemaking recommendations for resorts and marinas under lease with the department of natural resources. The process was established by the natural resources commission during a meeting held March 24, 1998 and made applicable to rate increases to become effective in 1999 and in subsequent years. The process was published in the Indiana Register on May 1, 1998 at page 3209 as Information Bulletin #20. Amendments were made to the information bulletin during the commission meeting held on May 20, 2003, and amendments were made effective July 1, 2003. The timeframes established by the information bulletin are essential to its effective implementation.

2. Rate Increase Requests

A lessee shall submit its request for a guestroom, slip, or houseboat (if applicable) fee increase to the department of natural resources, division of state parks and reservoirs (the "department") in accordance with the existing lease agreement for the following year by April 1 of the preceding year. The lessee shall include justification for the increase request along with comparable rates from other marinas.

3. Processing Rate Increase Requests and Comments

(A) Upon receiving a request, the department will inform the division of hearings of the natural resources commission (the "hearings division"). The hearings division will assign a cause number and, in consultation with the department, select the date and time for a rate hearing to be held in Marion County. The department will advise the lessee of the date, time, and location of the rate hearing, at which time the lessee and affected persons will have the opportunity to provide comments to a hearing officer for the commission. This hearing will be held in early June or July of each year.

(B) By May 30, the lessee shall notify by must provide written notice, by personal delivery or U.S. first class mail, to each slip renter or buoy renter that the lessee is requesting a rate increase. The lessee shall include the time, date, and location of the rate hearing. This notice shall include the proposed new rates. The notice shall also advise the renter of the opportunity to provide comments to the hearing officer, either by U.S. first class mail or electronic mail. Before the public hearing, the lessee must provide the hearings division with a listing that includes the names and addresses of persons notified under this paragraph. The lessee shall, by affidavit or affirmation, authenticate that all addressees were served as indicated in the listing. If the lessee asserts the listing contains trade secrets, the Uniform Trade Secrets Act (IC 24-2-3) applies.

(C) Petitions, requests, documentation, exhibits, and other pertinent materials concerning the proposed rate increase request shall be made available for the public to review at the lessee's business office, during normal business hours. A copy will be available for review at the Division of State Parks and Reservoirs, 402 West Washington Street, Room W298, Indianapolis, IN 46204. The listing of persons notified required in paragraph (B) is not governed by this paragraph.

(D) Affected persons may send written comments concerning the proposed rate increase to the Division of Hearings, Natural Resources Commission, 402 West Washington Street, Room W272, Indianapolis, IN 46204. Email comments may also be submitted to the hearing officer. The email address will be provided in the letter sent by the lessee to the affected parties by May 30.

(E) In accordance with the existing lease agreements, the department will analyze comparable facilities to compare rates with those sought by the lessee. Results of that analysis will be presented at the rate hearing conducted by the hearing officer. Information used in this analysis will also be available for inspection at the division of state parks and reservoirs office in Indianapolis.

4. Public Hearing and Presentation to Commission

Affected persons may attend the rate hearing and provide oral or written statements.

The hearing officer shall conduct the hearing in an orderly and informal manner designed to develop a fair and complete agency record. The administrative orders and procedures act (IC 4-21.5) does not apply, but the commission delegates authority to the hearing officer under IC 14-11-1-3 to make any reasonable orders to implement this information bulletin.

The lessee's request and any supporting documentation, written comments provided by affected persons, the analysis by the department, and oral and written statements received during the rate hearing form the record upon which the hearing officer shall review the request for rate increase. Following the completion of the review, the hearing officer shall make a written report to the natural resources commission. The report shall include written findings with respect to the requested rate increase and a proposal to the commission for recommendations to the U.S. Army Corps of Engineers. The hearing officer shall also forward a copy of the report to the lessee, the department, and any other person who requests a copy.

The hearing officer shall present the findings and recommendations to the natural resources commission during a meeting to be held in August or September. During that meeting, the commission shall either recommend approval of the rate increase, disapproval of the rate increase, or approval of a rate increase in an amount less than requested by the lessee. Recommendation for favorable consideration of a rate increase shall not be withheld unless, in the opinion of the commission, fees submitted exceed the fair market rates charged by operators of other similar privately-owned resort developments comparable to the project in the area.

5. Recommendation by Commission and Final Action by Army Corps

The commission's secretary shall memorialize the commission's recommendations in writing. Within seven (7) days after the commission meeting, the department shall forward the recommendation to the District Engineer of the U.S. Army Corps of Engineers for final action. No rate increase is effective until the lessee receives a letter of approval noting both the recommendation by the commission and the approval of a rate increase by the U.S. Army Corps of Engineers.

6. Interim Rate Adjustments or Clarifications

The commission delegates authority to the director of the division of state parks and reservoirs to approve interim rate adjustments for projects or slips not addressed in this process due to new construction or modification of existing facilities. The rates apply only until the next rate request cycle, however, when a lessee must present a petition for rate approval as provided in this information bulletin.

7. Index of Commission Findings and Recommendations

The hearings division is directed to index, and place on the commission's website, findings and recommendations made under this information bulletin after August 1, 2003. To promote equity and consistency, the department and the commission may consider these indexed findings and recommendations as precedents.

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #19
AUGUST 2003

DISCLAIMER: Commissioner's Directives are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations or court decisions is not binding on either the Department or the taxpayer. Therefore the information provided herein should only serve as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: FEDERAL BONUS DEPRECIATION DEDUCTION AS APPLIED TO INDIANA ADJUSTED GROSS INCOME

INTRODUCTION

This Directive is intended to explain the proper method for removing federal bonus depreciation from federal adjusted gross income in arriving at Indiana taxable income.

House Enrolled Act 1728, (2003), effective retroactive to January 1, 2003, is the legislation that is traditionally passed which updates the Indiana definition of federal adjusted gross income to the definition that is currently applicable in the Internal Revenue Code. Federal changes to adjusted gross income that were passed in March of 2002 included retroactive provisions that were effective as early as September 11, 2001. None of these provisions were incorporated by reference as of January 1, 2002. HEA 1728 incorporated all of these changes into the calculation of Indiana taxable income except for federal bonus depreciation.

I. DEFINITION OF BONUS DEPRECIATION

Bonus depreciation is defined in IC 6-3-1-33 to be an amount equal to that part of any depreciation allowance allowed in computing the taxpayer's federal adjusted gross income or federal taxable income that is attributable to the additional first year special depreciation allowance (bonus depreciation) for qualified property allowed under Section 168(k) of the Internal Revenue Code.

II. MODIFICATION TO ADJUSTED GROSS AND TAXABLE INCOME

IC 6-3-1-3.5 is the section of the Indiana Code that defines adjusted gross income and taxable income. Both terms start with the federal definition and then are modified for Indiana purposes. The modification that has occurred for 2003 and thereafter provides an adjustment for any taxpayer that owns property for which bonus depreciation was allowed in the current or an earlier taxable year. The adjustment is equal to the amount that would have been computed if an election had not been made to apply the bonus depreciation to the property in the year that it was placed in service.

This provision along with language in HEA 1728 SECTION 6, also prohibits a taxpayer from deducting any part of a depreciation allowance used to compute the additional first-year special depreciation allowance for any taxable year that began before January 1, 2003.

The depreciation allowance that is permitted will be the same calculation and schedule that was in effect for taxable years beginning before 2001. This is done through a three step process.

1. Add-back the thirty percent (30%) bonus depreciation in the first year so that Indiana depreciable values are one hundred percent (100%) of acquisition cost.

2. An adjustment must be made to all additional years of the life of the asset. The federal depreciation basis is seventy percent (70%) of cost for those years. The adjustment is necessary to bring the original basis for Indiana depreciation to one hundred percent (100%) of cost.

3. When the asset is sold, bonus depreciation is added back to the value when calculating a capital gain or depreciation recapture. An Indiana adjustment is necessary to reflect the correct amount of Indiana depreciation.

(Note: The federal Jobs and Growth Tax Relief Reconciliation Act of 2003 has increased bonus depreciation from thirty percent (30%) to fifty percent (50%) for property acquired after May 5, 2003.)

III. OTHER FEDERAL CHANGES INCORPORATED INTO INDIANA ADJUSTED GROSS INCOME

HEA 1728 incorporates all other federal changes by updating the Indiana Code to coincide with the federal changes. The incorporated changes include all of those changes that had retroactive application including extending the carryback of net operating losses for 2001 and 2002. Non-code language in HEA 1728 SECTION 7 that states that the definitional changes apply only to years beginning after January 1, 2003 only prevents the application of those updated, but non-retroactive provisions, to fiscal years in progress as of January 1, 2003.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE
COMMISSIONER'S DIRECTIVE #20
AUGUST 2003

DISCLAIMER: Commissioner's Directives are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations or court decisions is not binding on either the Department or the taxpayer. Therefore the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: COMPLIMENTARY ROOMS AND LODGINGS PROVIDED BY INNKEEPERS

INTRODUCTION

Effective July 1, 2003, House Enrolled Act 1001 (2003) SECTION 49 added IC 6-2.5-4-4.5 and SECTION 50 added IC 6-2.5-6-15 to provide that complimentary rooms and lodgings furnished by an innkeeper are subject to the sales tax. The amendment included mandatory reporting by the innkeeper at the same time that the innkeeper files a sales tax return.

The purpose of this directive is to outline the procedures to be followed in calculating the gross retail income that is attributed to providing complimentary rooms or lodgings by an innkeeper.

I. REPORTING REQUIREMENTS

A retail merchant that provides complimentary rooms or lodgings as part of doing business as an innkeeper shall report to the Department on a separate report the amount of complimentary lodgings provided by the innkeeper during the reporting period.
The reporting period will coincide with the sales and use tax reporting time frame. If the taxpayer reports on a monthly basis, the report is due at the same time that the monthly report is due. If the taxpayer remits their sales tax via electronic funds transfer, the report is due at the same time that the quarterly recap is due.

II. CALCULATION OF SALES TAX DUE FOR COMPLIMENTARY ROOMS

IC 6-2.5-4-4.5 states that the gross retail income attributed to providing of a complimentary room will be the amount of gross retail income received by the retail merchant from renting a comparable room or lodging on the date the complimentary room is provided.

The Department will allow the following calculation to be made monthly on a facility wide basis. The retail merchant will determine the gross retail income from the rental of rooms or lodgings during the month. This amount will be divided by the total room rentals during the month.

EXAMPLE: During June, a hotel that has 100 rooms and an 85% paid *occupancy rate* will have 2,550 room rental days (100*30*.85=2,550). If the gross retail income was $247,350, and there were 2,550 room rental days, the average daily room rental rate in June was $97.00. The $97.00 will be multiplied by the number of *complimentary rooms* provided to arrive at the gross retail income from complimentary rooms.

The above calculation can also be done on a daily basis.

The method used in calculating the sales tax that is due from the complimentary rooms must be used during the entire reporting period.

III. MISCELLANEOUS

For those innkeepers who intend to collect the tax from their customers, they may collect based on the previous month's average rate; however, they must remit the tax due based on the present rate, regardless of the method of calculation.

A room rented for a nominal amount will be considered to be complimentary.

The provisions contained in IC 6-2.5-4-4.5 do not apply to the innkeeper's taxes under IC 6-9.

Kenneth L. Miller

Commissioner

DEPARTMENT OF STATE REVENUE

02-970328.LOF

LETTER OF FINDINGS NUMBER: 97-0328
Gross Income Tax
For the Years 1993, 1994, 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Corporate Income Tax - Indiana Source Income

Authority: IC 6-2.1-2-2(a)(2), IC 6-8.1-5-1, 45 IAC 1-1-29, 45 IAC 1-1-49(6). Bethlehem Steel Corporation v. Indiana Department of Revenue, 597 NE2d 1327 (1992), First National Leasing and Financial Corporation v. Indiana Department of Revenue, 598 NE2d 640 (1992).

The taxpayer protests the assessment of tax on gross income that the taxpayer contends was not Indiana source income.

STATEMENT OF FACTS

The taxpayer is a subsidiary of a life insurance company and files as a regular corporation for Indiana income tax purposes. The taxpayer leases washers, dryers and other appliances to various customers in Indiana. The taxpayer reported some of the leases as operating leases and others as financing leases. The taxpayer reported the total payments on the operating leases as subject to the high rate of gross income tax on the entire payment. On financing leases, the taxpayer reported the interest earned as being subject to the high rate of gross income tax, but did not report any of that portion of the payment made by the customer which was related to the principle. In an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed gross income tax on the portion of the receipts related to the repayment of principle on the financing leases. The taxpayer protested the assessment and a hearing was held.

I. Corporate Income Tax- Indiana Source Income

DISCUSSION

Pursuant to IC 6-2.1-2-2(a)(2), Indiana imposes a gross income tax on, "the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or domiciliary of Indiana." To be taxable under this statute, there must be gross income from a source within Indiana. 45 IAC 1-1-29, which was in effect at the time of the audit, clarifies that a taxpayer's "...gross receipts derived from leasing real or personal property..." in Indiana are from a source in Indiana and subject to the gross income tax if the seller had business activity in Indiana. The business activities in the state, viewed as a whole, must be more than minimal to subject the activities to gross income taxation. Bethlehem Steel Corporation v. Indiana Department of Revenue, 597 NE2d 1327 (Tax Court 1992), First National Leasing and Financial Corporation v. Indiana Department of Revenue, 598 NE2d 640 (Tax Court 1992). The general rule is, then, that income derived from the lease of tangible personal property by a nonresident lessor to an Indiana lessee is subject to the gross income tax only if the seller had business activity in Indiana.

The taxpayer argues that it had no significant business activity subjecting it to Indiana taxation on the protested lease income. The taxpayer alleged that it did not maintain an office, warehouse, inventory or employees within Indiana. The taxpayer also alleged that it performed no services in Indiana and merely leased equipment that was already located in Indiana when purchased from unrelated third parties. The fact that the taxpayer was leasing property already located in Indiana indicates that the taxpayer was acquiring property in Indiana and then leasing it to Indiana customers. The leasing and rental of income-producing property establishes an Indiana business situs pursuant to 45 IAC 1-1-49(6) that states in pertinent part, "business situs" arises where there is "ownership, leasing, or other business activities connected with income-producing property(real or personal)" in Indiana. The taxpayer was engaging in an Indiana transaction and had an Indiana business situs subjecting it to Indiana gross income taxation.

Pursuant to IC 6-8.1-5-1, all tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. The taxpayer did not supply any documentation supporting its contentions concerning its activities in Indiana, the leases or the tangible personal property leased in Indiana.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04970462.LOF

LETTER OF FINDINGS NUMBER: 97-0462
SALES/USE TAX
For The Tax Periods: 1991 through 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax –Labels

Authority: IC 6-2.5-3-2, IC 6-2.5-5-6, 45 IAC 2.2-5-14, 45 IAC 2.2-5-12.

The Taxpayer protests the Department's assessment of use tax on labels.

II. Use Tax – Sampling Method

Authority: IC 6-8.1-4-2, IC 6-8.1-4-1, IC 6-8.1-5-1.

The Taxpayer protests the Department's method of sampling for its assessment of use tax.

STATEMENT OF FACTS

Taxpayer was audited for sales/use tax for the periods of 1991 through 1995. Taxpayer manufactures zinc die cast electrical connectors. Although some parts are completed at the out-of-state plant, most of the production parts are transported to the Indiana plant where labor intensive assembly and packaging operations are performed. The castings move through chamfer, broach, assembly, and thread operations of the Bodine machines and proceed to hand assembly before storage in the finished goods storage area. Packaging operations later bulk-pack the parts into cartons and affix labels bearing customers' names and logos. More facts supplied as necessary.

I. Use Tax: Labels

"An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana." IC 6-2.5-3-2. During the audit, the auditor assessed use tax on the labels placed on the cartons.

Taxpayer argues that the labels are part of the packaging process which is included in the production process, and are therefore exempt from taxation. They go on to state that the labels are not shipping labels, rather, they are customized labels with the reseller's name, a description of the parts contained within the package and other pertinent data.

IC 6-2.5-5-6 states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for incorporation as a material part of other tangible personal property which the purchaser manufactures, assembles, refines, or processes for sale in his business….

More specifically, 45 IAC 2.2-5-14 states in relevant part:

(d) The purchase of tangible personal property which is to be incorporated by the purchaser as a material or an integral part is exempt from tax. "Incorporated as a material or an integral part into tangible personal property for sale by such purchaser" means:

(1) That the material must be physically incorporated into and become a component of the finished product;

(2) The material must constitute a material or an integral part of the finished product; and

(3) The tangible personal property must be produced for sale by the purchaser.

(e) Application of the general rule.

(1) Incorporation into the finished product. The material must be physically incorporated into and become a component part of the finished product.

(2) Integral or material part. The material must constitute a material or integral part of the finished product.

(3) The finished product must be produced for sale by the purchaser.

First, Taxpayer incorrectly states that the labels are consumed in the production process. 45 IAC 2.2-5-12(g) defines the terms "consumed" as; "the dissipation or expenditure by combustion, use, or application…." Consequently, the exemption provided by 45 IAC 2.2-5-12(c) for purchases of materials to be directly consumed in the production process does not apply.

Second, Taxpayer also contends that the labels are part of the product being resold pursuant to IC 6-2.5-5-6. Taxpayer states that the customized labels are clearly part of the product being sold and without the customer's name and specification of the box, the items could not be resold. However, the finished goods are stored before packaging. Although the labels are customized, Taxpayer sells the fungible goods to the retailer, who in turn, sell the parts to the individual customer. Pursuant to IC 6-8.1-5-1, "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Here, Taxpayer has not demonstrated that the labels are incorporated as a material or integral part of the completed product pursuant to IC 6-2.5-5-6.

FINDING

The Taxpayer's protest is denied.

II. Use Tax: Sampling Method

DISCUSSION

Taxpayer protests the auditor's sampling method. The auditor made an adjustment for expenses by examining all the invoices for a particular month and calculating the amount that sales/use tax was not paid for each account examined. The auditor then divided that amount by the total of all invoices of each account for the sample month to determine the error percentage of each account. The auditor then applied that percentage for each selected account to the total for each account in each year included in the audit.

Taxpayer believes the month selected is not representative of the audit period as a whole. In addition, they state the month selected was at the end of the audit period and contend that the earlier years cannot be represented by one month several years later.

The Department may examine the books, records or other data bearing on the correctness of the returns. IC 6-8.1-4-2. Also, pursuant to IC 6-8.1-4-1(b)(2), the audit division may "annually audit a statistical sampling of the returns filed for the listed taxes that are not administered by the special tax division." The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made". IC 6-8.1-5-1.

Taxpayer has not provided any documentation to support their claim that the period selected was exceptional or provided any reasoning why a later period cannot be selected. The Department finds that the auditor acted within her authority to provide a statistical sampling for the audit periods in question.

FINDING

The Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04970510.LOF

LETTER OF FINDINGS NUMBER: 97-0510
Sales and Use Tax
Calendar Years 1993, 1994, 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Gross Retail Tax – Sales Tax included in Audit Figures

Authority: IC 6-8.1-5-1

Taxpayer protests the inclusion of sales tax in its proposed audit assessment.

II. Use Tax – "Deposits"

Authority: IC 6-2.5-3-2

Taxpayer protests assessments of use tax on amounts characterized as "deposits."

III. Use Tax – Services

Authority: IC 6-2.5-3-2

Taxpayer protests proposed assessments of use tax on costs associated with its purchase of services.

IV. Use Tax – Catering Services

Authority: IC 6-2.5-5-20; 45 IAC 2.2-4-45

Taxpayer questions proposed assessments of use tax on its purchases of catered meals.

V. Gross Retail Tax—Rental of Tangible Personal Property

Authority: IC 6-2.5-3-4, IC 6-2.5-3-6, IC 6-2.5-4-10

Taxpayer questions proposed assessments of use tax on its rental of tangible personal property.

VI. Gross Retail Tax—Taxes Previously Paid

Authority: IC 6-2.5-3-4

Taxpayer questions proposed assessments of tax on purchases in which sales tax was previously paid.

VII. Gross Retail Tax—Items Purchased for Resale

Authority: IC 6-2.5-5-8

Taxpayer questions proposed assessments of use tax on items purchased for resale.

VIII. Gross Retail Tax—Credit Card Purchases

Authority: IC 6-8.1-5-1, IC 6-8.1-5-4

Taxpayer questions proposed assessments of use tax on credit card purchases in which sales tax was previously paid.

STATEMENT OF FACTS

Taxpayer, an Indiana corporation, owns a professional hockey team. In operating its hockey franchise, taxpayer derives business income from a variety of sources—e.g., ticket sales, advertising sales (display sign space and program ads), novelties, and program sales. Other business income is generated from concession commissions and expansion team fees. Taxpayer generates additional business income from its training camp operations.

In conjunction with its business operations, taxpayer purchased tangible personal property as well as services from a number of vendors—vendors located both within and without the state. Some purchases qualified for Indiana sales and use tax exemptions, others did not. Concerning those transactions in which taxpayer neither paid sales tax nor remitted use tax to the state, taxpayer failed (or was unable) to provide documentation in support of exempt status. Audit also noted taxpayer's failure in establishing a use tax accrual system.

Taxpayer's collective failures resulted in additional sales and use tax assessments. Taxpayer has protested many of these. An administrative hearing was held. The results of which now follow.

I. Gross Retail Tax – Sales Tax included in Audit Figures

DISCUSSION

For all years at audit, it was determined that the taxpayer's "sales subject to collection of sales or use tax as agent for the state" already included sales tax. The auditor had previously agreed to adjust the audit.

FINDING

Taxpayer's protest is sustained.

II. Use Tax –"Deposits"

DISCUSSION

Audit assessed use tax on taxpayer payments (transaction dates 09/12/95 and 11/17/95) made to an out-of-state vendor. (BE). Taxpayer has protested one of these assessments—specifically, the 09/12/95 assessment.

Taxpayer contends the September payment represented a refundable deposit rather than a payment for the rental of tangible personal property. Subsequent to audit, taxpayer submitted documentation to support its position. Audit now agrees. The Department, therefore, will remove the contested amount ($1,075.00) from the total sales figure that is subject to additional use tax assessments.

FINDING

Taxpayer's protest is sustained.

III. Use Tax—Services

DISCUSSION

In conducting its business activities, taxpayer has purchased tangible personal property and personal services from a number of vendors. At the time of audit, taxpayer was unable to provide documentation (primarily invoices) showing whether sales tax had been paid (or should have been paid) on many of these purchases. Audit, therefore, assessed use tax on each undocumented purchase. In response, taxpayer provided additional information to show that some of these "undocumented" purchases were for non-taxable services. To wit:

01/09/95	AM	1,721.56
09/28/95	AF	5,350.00
10/03/95	GP	5,500.00
09/12/95	"	850.00
11/03/95	"	850.00
01/31/95	KE	2,450.00
02/10/95	"	2,450.00
03/31/95	NE	900.00
03/31/95	UE	1,750.00
04/03/95	"	1,000.00
10/25/95	BI	1,300.00
02/21/95	NI	7,395.00

Taxpayer's outstanding use tax liabilities, therefore, will be adjusted accordingly.

Taxpayer also contests Audit's assessments of use tax on payments made to SG Productions— (10/18/95 6,500.00; 10/24/95 2,500.00; 01/13/95 3,500.00, and 11/13/95 2,500.00). Taxpayer has submitted a statement to the Department indicating that its payments to SG Productions represented non-taxable personal appearance fees. Taxpayer statement, without more, is insufficient. Taxpayer needs to forward source documents along with an explanation obtained from SG Productions that the payments in question were for personal appearances.

FINDING

Taxpayer's protest is sustained to the extent use tax was assessed on taxpayer's purchase of the aforementioned documented services. Taxpayer's protest is sustained, conditionally, with regard to the SG Productions purchases.

IV. Gross Retail Tax – Catering Services

DISCUSSION

During the audit period, taxpayer purchased catered meals. At the time of these purchases, sales tax was not paid. Subsequent to purchase, taxpayer also failed to self-assess and remit use tax on the purchase price of these catered meals. Audit, therefore, proposed additional assessments of use tax.

Sales of food for human consumption are exempt from Indiana sales tax. IC 6-2.5-5-20(a). However, the term "food for human consumption" does not include "meals served by a retail merchant off the merchant's premises." IC 6-2.5-5-20(c)(9). The Department has interpreted the language of IC 6-2.5-5-20(c)(9) as applying to those who provide catered meals.

> The law provides that the sale of meals shall be taxable whether such meals are served on or of the premises of the retailer. *Accordingly[,] the sale of food or meals by caterers is subject to sales tax.*
>
> 45 IAC 2.2-4-45(a). (Emphasis added.)

FINDING

Taxpayer's protest is denied.

V. Gross Retail Tax – Rental of Tangible Personal Property

DISCUSSION

On three separate occasions (02/21/95, 10/27/95, 11/29/95), taxpayer rented "music and sound equipment" from an in-state vendor (MA). Taxpayer did not pay sales tax to the vendor at the time of rental. Taxpayer did not self-assess and remit use tax on the rental transactions. Audit, therefore, proposed additional assessments of use tax.

The renting or leasing of tangible personal property in Indiana represents a taxable transaction for purposes of the Indiana gross retail tax. That is, "[a] person…is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person." IC 6-2.5-4-10(a). Because sales tax was not collected at the time of these rental retail transactions, taxpayer should have self-assessed and remitted use tax on the rental payments. *(See IC 6-2.5-3-4 (exemption from use tax if the state gross retail tax has been paid) and IC 6-2.5-3-6 (person who uses…the tangible personal property acquired in a retail transaction is personally liable for the use tax).)* As the vendor did not require taxpayer to pay the former (i.e., sales tax to the vendor) and taxpayer failed to remit the latter (i.e., remit use tax to the Department), the assessments of use tax were proper.

FINDING

Taxpayer's protest is denied.

VI. Gross Retail Tax – Tax Previously Paid

DISCUSSION

Taxpayer acquired office equipment in a retail transaction. (02/10/95, SO, $587.32.) During audit, taxpayer was unable to produce an invoice (or other documentation) to support its contention that sales tax had been paid (i.e., collected by the vendor) at the time of the transaction. Subsequently, the vendor (SO) submitted a one-sentence facsimile to the Department: "Please be advised that [Taxpayer] is charged sales tax."

Taxpayer's burden of production is incomplete. In order for the Department to sustain taxpayer's protest of this issue, taxpayer must acquire and submit the appropriate source documents from the vendor which were used to support the assertion that the vendor charged taxpayer sales tax on its 02/10/95 purchase.

FINDING

Taxpayer's protest is sustained if at the time of supplemental audit, taxpayer can produce the requested source documents.

VII. Gross Retail Tax – Items Purchased for Resale

DISCUSSION

Taxpayer, in retail transactions, purchased tangible personal property. At the time of purchase, taxpayer did not pay sales tax. Taxpayer argues that its purchases were exempt from Indiana's gross retail tax because the items in question were purchased for resale.

Taxpayer is correct. If the items were purchased for subsequent resale, the purchase transactions qualify for an exemption from the state's gross retail tax (i.e., sales tax). IC 6-2.5-5-8 states in part:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental or leasing in the ordinary course of his business….

The question then becomes one of proof. That is, can taxpayer show the disputed items were subsequently "resold" in the ordinary course of taxpayer's business? The transactions at issue involve purchases of tangible personal property from (AGS), (CP), (IHL), (TF). Taxpayer classified the expenses associated with the purchase of items from these four vendors as "Miscellaneous General & Administrative Expenses." Nothing has been brought to the Department's attention to suggest, prove, or establish that such items have been resold.

FINDING

Taxpayer's protest is denied.

VIII. Gross Retail Tax –Credit Card Purchases

DISCUSSION

Taxpayer purchased a variety of items. Taxpayer paid for some of these items with a credit card—specifically, a Visa credit card. Other than the credit card payment receipts, no other documentation exists (or has been provided to the Department) regarding these purchases. Taxpayer contends the amount entered on each credit card receipt represents the purchase price inclusive of sales tax. Audit, on the other hand, reasons that since sales tax was not explicitly stated on the credit card receipts, use tax was due.

In order for the Department to administer the state's tax laws in an manner consistent with its statutory mandate, a taxpayer "must keep books and records so that the department can determine the amount, if any, of the person's liability…." IC 6-8.1-5-4. Similarly, with regard to tax assessments, "[t]he burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b).

The Department has invited taxpayer to submit documentation showing that the amounts reported on taxpayer's credit card receipts represented both the purchase price paid as well as sales tax paid. Such proof has not been forthcoming. Consequently, the assessments must stand.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02-980590.LOF

LETTER OF FINDINGS NUMBER: 98-0590
GROSS INCOME TAX
For Years 1994 and 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax –Freight Allowance

Authority: 45 IAC 1-1-33; IC § 6-8.1-5-4

Taxpayer protests the addition of delivery charges to its gross income.

II. Gross Income Tax –Freight Allowance

Taxpayer requests an adjustment to its sales factor based on addition of delivery charges to its gross income.

III. Gross Income Tax –Deduction for Income Taxes

Taxpayer requests an adjustment to its gross income for other income taxes paid by taxpayer.

STATEMENT OF FACTS

Taxpayer operation at issue involves various sand and gravel sites in Indiana selling and arranging delivery of materials to customers. As part of an audit, the auditor was given several different answers to the same question regarding delivery charges for the materials, and concluded the charges were borne by the taxpayer and this income was attributable to the taxpayer's operations. Taxpayer maintains the materials were shipped Free on Board and that the delivery income was not attributable to the taxpayer's operation.

I. Gross Income Tax –Freight Allowance

DISCUSSION

The overlying issue for the taxpayer's protest is the audit's assessment of tax based on statements by taxpayer's staff and inferences drawn from the documentation available to the auditor. Auditor made adjustments based on discrepancies in the amounts reported on the taxpayer's ST-103's, and the amounts on the taxpayer's gross income return for the year. Taxpayer contends that the inferences resulting in assessment were not properly drawn; inasmuch as the ST-103's included amounts for the accrued haul charges, representing charges for freight that are arranged by the taxpayer on behalf of the purchaser and which were reimbursed by the purchaser. Taxpayer alleges that the selling terms of taxpayer's aggregate products is that the purchaser takes title to the aggregate materials at the sales location and that the shipping terms are Free on Board at the point of origin. Taxpayer then maintains 45 IAC 1-1-33 exempts a seller's reimbursement for buyer's shipping expenses from gross income tax and consequently this adjustment was incorrect. This provision states in relevant part:

> If freight is at the purchaser's expense and it is advanced on his behalf by the seller, the seller's reimbursement for such expense by the buyer is not subject to gross income tax. If there is an F.O.B. point mentioned in the contract and it is at the origin of shipment, this indicates that any further expense of delivery is an expense of the purchaser….The terms "freight paid" and "freight prepaid" disclose the payment of freight by the seller which, dependent on the stated delivery terms, may or may not be the seller's expense. The term "freight collect" discloses the payment of freight by the purchaser which also, dependent upon the stated delivery terms, may or may not be the purchaser's expense.

The exemption which is granted by this regulation is dependent on sufficient and specific documentation to confirm the structure of the transaction. Thus, this issue revolves around the burden of proof in an audit situation, which IC § 6-8.1-5-4 defines as:

> Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records in this subsection include *all source documents necessary to determine the tax*, including invoices, register tapes, receipts, and canceled checks. *(Emphasis added)*

Taxpayer admits the auditor received conflicting statements at the time of the audit. Furthermore, the record does not demonstrate any contemporaneous documentation supporting taxpayer's position either made available to the auditor or presented at the hearing. Taxpayer did present a current invoice demonstrating that all shipments are presently free on board at the origin and the charges are borne by the customer, not the taxpayer. Taxpayer has not provided information that overrides the initial adjustment, which was based on taxpayer's contemporaneous filings, statements by taxpayer's staff, and contemporaneous documentation available to the auditor.

FINDINGS

Taxpayer's protest is denied.

II. Gross Income Tax –Freight Allowance

DISCUSSION

Taxpayer requests that if the Department determines that the shipments were FOB, they not be added to the numerator of the taxpayer's sales factor. Taxpayer concurs that the resolution of the preceding issue is dispositive of this issue. Taxpayer also requests that if the Department does include the freight charges in the numerator of the sales factor, they should be included in the denominator as well, to correctly reflect the apportionment proportions.

FINDINGS

Taxpayer's protest is denied as to the removal of the charges from the sales factor numerator and sustained as to the inclusion of the freight charges in the denominator.

III. Gross Income Tax –Deduction for Income Taxes

DISCUSSION

The auditor added back to income an item described as "other taxes" on the basis that the taxpayer did not provide any details and therefore the amount deducted was assumed to be income taxes. Taxpayer has now provided details related to these other taxes, and to the extent that they establish these taxes as income taxes, taxpayer protest is sustained.

FINDINGS

Taxpayer's protest is sustained pending audit verification.

DEPARTMENT OF STATE REVENUE

04990127.LOF

LETTER OF FINDINGS NUMBER: 99-0127
SALES AND USE TAX
FOR TAX PERIODS: 1995-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

I. Sales and Use Tax: Manufacturing Exemptions

Authority: IC 6-2.5-3-2 (a), IC 6-2.5-5-3, IC 6-2.5-5-5.1, 45 IAC 2.2-5-10 (c), 45 IAC 2.2-5-10 (h)(2), 45 IAC 2.2-5-12, *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983). *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998), 2003 Indiana LEXIS 117.

The taxpayer protests the assessment of use tax on certain items of tangible personal property.

II. Tax Administration: Abatement of Penalty

Authority: IC 6-8.1-10-2.1, 45 IAC 15-11-2 (b).

The taxpayer protests the assessment of the penalty.

STATEMENT OF FACTS

The taxpayer is in the business of selling, servicing, and rebuilding electrical motors, pumps, and gearboxes. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax, interest, and penalty. The taxpayer protested a portion of the assessment and a hearing was held to determine the sales and use taxability of certain items used in the taxpayer's rebuilding process.

I. Sales and Use Tax: Manufacturing Exemptions

The taxpayer agrees that some of its activities constitute repair. Materials used in the provision of a repair service are subject to the use tax pursuant to IC 6-2.5-3-2 (a). The taxpayer's protest to the assessment of tax on property used in the provision of repair services is denied.

The remainder of the taxpayer's protest concerns its tax liability in the rebuilding or remanufacturing of certain pumps and motors. In this process, the taxpayer typically picks up the non-working or poorly performing electric motors and pumps of its customers and transports them to its production facility. Such non-functioning or unusable motors and pumps are visually inspected and often tested by the taxpayer using a test panel in order to determine the mechanical problem at issue. The taxpayer then makes a determination as to the problem(s) involved and whether the electric motor or pump is salvageable. Customers are then given a choice of purchasing a new motor or having the old motor remanufactured. Unsalvageable motors and pumps are discarded by the taxpayer.

If the motor or pump is salvageable and the customer desires remanufacture, the taxpayer's documentation indicates that ownership of the equipment transfers to the taxpayer. Then the taxpayer will disassemble the item down to its castings. Often heavy equipment is used to assist the taxpayer in the disassembly process. If the windings (windings are copper wires that are coiled to produce the proper magnetic field for the motor or pump) of the motor or pump need to be replaced, such windings will be removed. Removal of windings requires baking the motor in an oven to loosen the varnish on the windings, which is stripped after the baking process. The windings are then torn out of the slot in the motor frame. New windings are inserted and new paper insulation is added. Then varnish is applied to the windings and the windings are baked in the oven to harden the varnish. The new windings are often of similar design, or the taxpayer will install upgraded windings in order to make the motor or pump more efficient than when it was purchased. Often ball bearings, lubricants, lubricant meters and tubing, hydraulic pumps and systems, and other parts are replaced, as needed. Also, all gears, shafts and end bells (the part that holds shafts in place) will be inspected and realigned. If the shafts are bent or warped then they will be realigned using special equipment. Often a realignment or machining of a motor or its parts will require the motor to be rebalanced. If necessary, the end bells and pump shafts will be machined on metal lathes. Next, all welds will be redone as needed and the items will be varnished and painted. Finally, upon reassembly of the motor or pump, such remanufactured item will be retested on the test panel to determine its performance and capacity and if such performance and capacity has changed from its original specifications when the motor was newly purchased. Also, a new nameplate describing the item's amps and capacity is affixed to such item. Skilled technicians provide these functions. The taxpayer provides its customers with a one-year warranty on all remanufactured motors and pumps. The department's audit assessed use tax on many items used in this process. The taxpayer protested the assessment of use tax on the items it used in the rebuilding process. After the hearing, the taxpayer withdrew its protest to a portion of the items originally protested.

Pursuant to IC 6-2.5-3-2 (a), Indiana imposes an excise tax on tangible personal property stored, used, or consumed in Indiana. There is no exemption available for tangible personal property used in the provision of a service.

A number of exemptions are available from use tax, including those collectively referred to as the manufacturing exemptions. IC 6-2.5-5-3 provides for the exemption of "manufacturing machinery, tools and equipment which is to be directly used by the purchaser in the direct production, manufacture, fabrication... of tangible personal property." (the equipment exemption) In *Indiana Department of Revenue v. Cave Stone*, 457 N.E. 2d 520, (Ind. 1983) the Indiana Supreme Court found that a piece of equipment qualifies for the manufacturing exemption if it is essential and integral to the production process. 45 IAC 2.2-5-10 (c) describes manufacturing machinery and tools as exempt if they have an immediate effect on the property in production. 45 IAC 2.2-5-10 (h)(2) further clarifies the exemption by allowing the exemption of "Replacement parts, used to replace worn, broken, inoperative or missing parts or accessories on exempt machinery and equipment..." IC 6-2.5-5-5.1 provides for the exemption of tangible personal property "... if the person acquiring the property acquires it for the direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing,..." (the consumption exemption) Pursuant to 45 IAC 2.2-5-12, consumption of tangible personal property in the direct production process means "dissipation or expenditure by combustion, use, or application..." of the tangible personal property in an "essential and integral part of an integrated process which produces tangible personal property."

Both the equipment and consumption manufacturing exemptions require that the subject item be used in a production process.

The taxpayer contends that the protested items qualify for either the equipment or consumption exemption. The department assessed use tax on the protested items because the department determined that the items were used in the service of repairing engines and pumps rather than a true production process. The first issue to be determined here is whether the protested items were actually used in the provision of a service or in a production process as the taxpayer contends.

To support its contention that the taxpayer is actually remanufacturing the engines and pumps in a production process rather than providing a repair service, the taxpayer cites *Rotation Products v. Indiana Department of State Revenue*, 690 N.E.2d 795, 803 (Ind. Tax. Ct. 1998). In that case, Rotation Products Corporation successfully argued that it took raw materials in the form of unusable roller bearings and created an entirely new product, i.e., the remanufactured roller bearings. The Court found that this was a production process and not the provision of a service. To reach this conclusion, the Court instituted the following four-prong test to distinguish a production process from the provision of a service. First, a production process must be complex and substantial and produce a different end product. Secondly, the property must become more valuable in the process. Thirdly, the end product of the process must compare favorably with newly manufactured articles of its kind. Finally, the process must not be part of the normal life cycle of the original product.

First, like the taxpayer in Rotation Products, the taxpayer performs substantial and complex work and significantly changes the electric motors and pumps that it remanufactures. The taxpayer tests non-working or poorly working electric motors and pumps to determine the mechanical problem at issue. The taxpayer then determines the problems involved and whether the electric motor or pump is salvageable. If it is salvageable and the customer prefers remanufacture to the purchase of new equipment, the taxpayer disassembles the item. In a complicated multi-step process, the taxpayer then removes the old windings, discards the old windings, and installs new and often improved windings in the motor. This process is similar to the Rotation Products Corporation enhancing the bearings by adding new rolling elements and cages. *Id*. at 803-04. The new windings must then be varnished and the varnish baked in an oven. The taxpayer also replaces ball bearings, lubricants, lubricant meters and tubing, hydraulic pumps and systems as needed. This is also similar to the Rotation Products Corporation enhancing the bearings by adding new rolling elements and cages. *Id*. at 803-04. Next the taxpayer inspects and realigns as necessary all gears, shafts and end bells. Finally, the end bells are grounded, machined, and polished on metal lathes and joints are rewelded. The reassembled and remanufactured motor or pump is then tested to determine its capacity and output. After testing, a new nameplate describing the amps and capacity of the motor or pump is affixed to the item. The taxpayer issues a one-year warranty with the remanufactured AC and DC wound motors or pumps and a two-year warranty on 3 phase motors similar to the warranty offered by the Rotation Products Corporation. *Id*. at 803.

Secondly, the property must become more valuable in the process. The taxpayer takes nonusable motors and pumps and transforms them into marketable motors and pumps. Before the remanufacturing process, the only value of the motors and pumps is as scrap metal. After the remanufacturing process, the motors and pumps are functional and oftentimes more powerful than the original item.

The remanufactured motors and pumps also compare favorably with similar new items. The remanufactured items sell for approximately 80% of the price of a new motor or pump.

Finally, the taxpayer's remanufacturing of the electric motors and pumps is not part of such property's normal life cycle. In *Rotation Products*, the Court noted that even if the cleaning and polishing of bearings is routine maintenance that is a normal part of such bearings' lifecycle; grinding bearing surfaces and replacing roller cages and elements are not. *Id.* at 803-04. Similarly, even if the taxpayer's cleaning, painting, and polishing the motors and pumps is routine maintenancein the normal lifecycle; the rewinding process, the shaft realignment, and the machining of end bells is not.

Application of the Court's test to the taxpayer's situation indicates that the taxpayer is engaged in the process of production of motors and pumps rather than the provision of a service.

Recently, the Indiana Supreme Court determined that to qualify for the manufacturing exemptions, a taxpayer must be involved in the production of a "distinct marketable good." Indiana Department of Revenue v. Interstate Warehousing, Inc., 2003 Indiana LEXIS 117. Further, the Court indicated that in order to be engaged in the production of a marketable good, the taxpayer must be producing something that will be sold. Id. at 9. The taxpayer meets this requirement as the documentation indicates that the taxpayer takes title to the motors prior to rebuilding and the taxpayer's customers purchase the motors back after rebuilding. It does not even appear that the customer will get the same motor back.

Since it has been determined that the taxpayer actually produces a marketable product in a production process, the second issue is to determine whether the protested items actually qualify for the equipment and consumption manufacturing exemptions. The taxpayer's explanations of the use of the items in the production process indicate that they qualify for either the equipment or consumption manufacturing exemption.

FINDING

The taxpayer's protest as to portion of materials used in the provision of the repair service is denied. The taxpayer's protest as to the materials used in the remanufacture of pumps and motors is sustained subject to a supplemental audit.

II. Tax Administration: Abatement of Penalty

The taxpayer's final point of protest concerns the imposition of the ten per cent negligence penalty pursuant to IC 6-8.1-10-2.1.

Indiana Regulation 45 IAC 15-11-2 (b) clarifies the standard for the imposition of the negligence penalty as follows:

> "Negligence", on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence.

During the audit period, the taxpayer failed to pay sales or use tax on several types of items such as cleaning supplies, office supplies, and magazine subscriptions. The department's publications clearly indicate that purchase and use of these items is subject to the tax. The taxpayer's failure to pay tax according to the departmental instructions constitutes negligence.

FINDING

The taxpayer's final point of protest is denied.

DEPARTMENT OF STATE REVENUE

04990158.LOF

LETTER OF FINDINGS NUMBER: 99-0158
Use Tax
Calendar Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Use Tax – Taxable purchases

Authority: 45 IAC 2.2-3-20

Taxpayer protests the use tax on items that have sales tax assessed and paid.

II. Tax Administration – Penalty

Authority: I C 6-8.1-10-2.1; 45 IAC 15-11-4

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is an accounting/consulting firm that has no sales of tangible personal property. Taxpayer failed to pay tax on the purchase of computer components, software, office supplies, publications, and other taxable items. At audit, taxpayer disagreed with the auditor on several items but failed to provide proof. In a letter dated March 18, 1999 taxpayer stated it could produce invoices showing tax paid, that the dinner party and lawn application were service items and, therefore, not subject to sales tax, and the software, publications, and supplies were purchased out of state, therefore exempt. After many cancelled hearings and attempts in resolving the issue, a hearing was held on May 7, 2003.

I. Use Tax – Taxable purchases

DISCUSSION

At audit taxpayer was assessed use tax for items that did not include sales tax and items on its depreciation list where no invoices were presented. At hearing, taxpayer stated he would supply copies of invoices by May 14, 2003.

Taxpayer has not provided the department with proof that the audit is in error.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Penalty

DISCUSSION

Taxpayer did not protest the penalty. The department addresses the penalty issue as a matter of courtesy.

Taxpayer failed to remit use tax as required under 45 IAC 2.2-3-20, which is clearly negligent.

Taxpayer is a certified public accountant and aware of the use tax laws of the State of Indiana.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420000287.LOF

LETTER OF FINDINGS: 00-0287
Gross Retail Tax
For the Years 1997 and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Transactions Subject to Sales Tax – Sale for Resale or Lease.

Authority: IC 6-2.5-2-1; IC 6-2.5-5-8; IC 6-8.1-5-1(d); Monarch Steel v. State Bd. of Tax Comm'rs, 699 N.E.2d 809 (Ind. Tax Ct. 1998); Trinity Episcopal Church v. State Bd. of Tax Comm'rs, 694 N.E.2d 816 (Ind. Tax Ct. 1998); 45 IAC 2.2-8-12(a); 45 IAC 2.2-8-12(b); 45 IAC 2.2-8-12(c); 45 IAC 2.2-8-12(d).

Taxpayer argues that transactions involving the sale of car washing equipment to three of its customers were not subject to the gross retail (sales) tax because those same three customers later resold or leased the equipment.

STATEMENT OF FACTS

Taxpayer is an S corporation in the business of operating car wash establishments. Taxpayer is also in the business of selling and distributing car washing equipment and supplies to various gas stations and convenience stores. Occasionally, taxpayer will arrange for installation of the equipment at the customer's location.

The Department conducted an audit of taxpayer's financial records and tax returns. The audit determined that taxpayer owed additional sales and use tax. Among other reasons, the audit found taxpayer owed the additional tax because it collected sales tax but failed to remit it to the state and because the audit determined that certain transactions were not exempt.

In addition, the audit noted that taxpayer had either not received, or had not retained, exemption certificates from certain customers. After taxpayer was unable to obtain the missing exemption certificates during the time permitted, the audit assessed additional tax on those particular sales for which no exemption certificate was provided.

Taxpayer submitted a protest of the additional assessment believing it could demonstrate that the source transactions were exempt from sales tax. An administrative hearing was held, and this Letter of Finding follows.

DISCUSSION

I. Transactions Subject to Sales Tax – Sale for Resale or Lease.

Taxpayer agrees that it sold car washing equipment to the three customers but argues that the transactions with each of these particular customers were not subject to sales tax.

Pursuant to IC 6-2.5-2-1, a sales tax is imposed on retail transactions which occur within the state unless a valid exemption is applicable.

IC 6-2.5-5-8 provides a sales tax exemption for transactions involving the sale of tangible personal property acquired by the customer for resale, rental, or leasing. Specifically, the statute reads as follows:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental or leasing in the ordinary course of his business without changing the form of the property.

Typically, a purchaser of personal property exempt under IC 6-2.5-5-8 issues an "exemption certificate" to establish that the personal property being acquired will be used in an exempt manner. 45 IAC 2.2-8-12(a) reads in part that, "Retail merchants, manufacturers, wholesalers and others who must register with the Department of Revenue and who qualify to purchase exempt from tax under this Act may issue exemption certificates with respect to exempt transactions."

Because the taxpayer was engaging in retail transactions by selling its car washing equipment and supplies, its initial obligation was to collect the sales tax. 45 IAC 2.2-8-12(b) states, "Retail merchants are required to collect the sales and use tax on each sale which constitutes a retail transaction unless the merchant can establish that the item purchased will be used by the purchaser for an exempt purpose."

The Department presumes that every intra-state sale of tangible of personal property is subject to sales tax; it is the buyer's and the seller's obligation to establish that the particular transaction is exempt. The simplest way to meet this burden is for the buyer to issue an exemption certificate. 45 IAC 2.2-8-12(c) provides that, "All retail sales of tangible personal property for delivery in the state of Indian shall be presumed to be subject to sales or use tax until the contrary is established. The burden of proof is on the buyer and also on the seller unless the seller received an exemption certificate."

Because the taxpayer was unable to supply copies of the missing exemption certificates, the audit correctly assumed that the transactions with the three customers were subject to the gross retail tax. However, taxpayer now asserts that it can demonstrate the sales to the three customers were exempt. 45 IAC 2.2-8-12(d) provides the taxpayer two alternative means of doing so. "Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose."

Because the audit determined the transactions with the three customers were not exempt, the taxpayer now has "[t]he burden of proving that the proposed assessment is wrong." IC 6-8.1-5-1(d). In determining whether a taxpayer is entitled to an exemption, such as that provided for in IC 6-2.5-5-8, the courts have held that the exemption is to be strictly construed against the taxpayer and in favor of taxation. Monarch Steel v. State Bd. of Tax Comm'rs, 699 N.E.2d 809, 811 (Ind. Tax Ct. 1998); Trinity Episcopal Church v. State Bd. of Tax Comm'rs, 694 N.E.2d 816, 818 (Ind. Tax Ct. 1998).

Because the circumstances surrounding the sales to the three customers vary and because taxpayer's efforts to demonstrate the various transactions with the three customers also vary, the transactions with three customers are addressed individually.

A. Customer One:

In the case of Customer One, taxpayer has been able to provide a copy of an exemption certificate. The exemption certificate was signed on January 12, 2000, was prepared by Customer One's vice-president, and states that "all purchases of tangible personal property from [taxpayer] dating from 3/31/98 to 3/31/98 by the undersigned on which sales or use tax was not paid at time of purchase were used for a purpose which is exempt under provisions of the Indiana Gross Retail Tax Act." Therefore, in regard to Customer One, taxpayer has plainly met its burden of demonstrating that it was not required to collect sales tax on the sales of tangible personal property to Taxpayer One which occurred on "3/31/98."

B. Customer Two:

According to taxpayer, Customer Two is a financing agent. Although taxpayer negotiates with the end-user of the car washing equipment – such as a gas station or a convenience store – the typical end-user has neither the means nor the inclination to purchase the equipment directly from taxpayer. Instead, once the end-user expresses an interest in obtaining the equipment, taxpayer introduces the prospective end-user to a financing agent, such as Customer Two, which can provide the necessary financing. Thereafter, taxpayer sells the equipment to the financing agent, the financing agent pays taxpayer the total cost of the equipment, the equipment is delivered directly to the end-user, and the end-user makes successive payments to the financing agent.

Taxpayer argues that its sales to Customer Two – now no longer in business – were exempt from sales tax because Customer Two was in the business of leasing the equipment to the end-user. Taxpayer relies on IC 6-2.5-5-8, which exempts sales "if the person acquiring the property acquires it for resale, rental, or *leasing in the ordinary course of his business...."* (*Emphasis added*). Taxpayer was not able to obtain an exemption certificate from Customer Two. Instead, taxpayer has provided a copy of an invoice taxpayer sent Customer Two. The invoice lists Customer Two's out-of-state address and indicates that the equipment is to be delivered to a third-party – presumably the end-user – located at an in-state address. In addition, the invoice states that, "Any applicable taxes are responsibility of [Customer Two]." Presumably, this last statement is a stipulation between the two contracting parties requiring Customer Two to collect sales tax from the individual end-user.

Insofar as the sales transactions with Customer Two, taxpayer has failed to "prove that sales tax was collected and remitted to the state or that the purchaser [Customer Two] actually used the item for an exempt purpose." 45 IAC 2.2-8-12(d). Standing alone, the invoice sent Customer Two is insufficient to establish Customer Two purchased the car wash equipment for an exempt purpose or that the gross retail tax was ever paid to the state.

C. Customer Three:

Taxpayer indicates that Customer Three was also a financing agent. As a result, taxpayer maintains its sales of equipment to Customer Three were exempt from sales tax under IC 6-2.5-5-8 because Customer Three acquired the equipment in order to lease it to third-party end-users. Because taxpayer has not submitted a copy of the relevant exemption certificates, the transactions are presumably subject to sales tax, and taxpayer has the burden of proving that the transactions were exempt. IC 6-8.1-5-1(d); 45 IAC 2.2-8-12(c).

As in the case with Customer Two, taxpayer has submitted a copy of an invoice it sent to Customer Three indicating Customer Three was located at an out-of-state location and that the equipment was delivered to a third-party which had a different, in-state address. In addition, taxpayer has submitted a copy of what purports to be Taxpayer Three's standard lease agreement form. The lease agreement form states that the "[Third-Party Lessee] shall pay all charges and taxes (local, state, and federal) which now be imposed upon the ownership, leasing, rental, sale, purchase possession, or use of the Equipment...."

In further support of its argument, taxpayer has provided a copy of a letter dated December 1997 and received from Customer Three. In that letter, Customer Three indicates that the Named End-User has "entered into a lease agreement with [Named End-User] covering equipment purchased from your firm." The letter also requests taxpayer to, "[p]lease be sure no tax appears on the invoice."

Insofar as its transactions with Customer Three, taxpayer has met its burden of proving that Customer Three purchased the car wash equipment – which it subsequently transferred to the Named End-User indicated in the December 1997 letter – "for an exempt purpose." 45 IAC 2.2-8-12(d). Accordingly, taxpayer is entitled to the sales tax exemption set out in IC 6-2.5-5-8 for the sale of equipment made to Customer Three and which was subsequently leased to the Named End-User.

FINDING

Taxpayer's protest is sustained in part and respectfully denied in part. Taxpayer is entitled to the exemption on sales made to Customer One on "3/31/98." Taxpayer is not entitled to an exemption on sales made to Customer Two. Taxpayer is entitled to the exemption on sales of equipment made to Customer Three and thereafter leased to the Named End-User identified in the December 1997 letter.

DEPARTMENT OF STATE REVENUE

0420010143.LOF

LETTER OF FINDINGS NUMBER: 01-0143
State Gross Retail Tax—Burden of Proof for Exemptions
Tax Administration—Penalty
For Tax Year 1997

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. State Gross Retail Tax—Burden of Proof for Exemptions

Authority: IC § 6-2.5-2-1, 45 IAC 2.2-2-1, IC § 6-2.5-3-2, 45 IAC 2.2-2-2, IC § 6-8.1-5-1, 45 IAC 2.2-5-53, 45 IAC 2.2-8-2, 45 IAC 2.2-8-12

Taxpayer protests the state gross retail tax assessment on items for which taxpayer claims to have valid exemptions.

II. Tax Administration—Penalty

Authority: IC § 6-8.1-10-2.1, 45 IAC 15-11-2

Taxpayer protests the assessment of the 10% negligence penalty.

STATEMENT OF FACTS

Taxpayer was a wholesale distributor of consumer electronics (satellite dishes). In addition, taxpayer sold C-Band programming through its programming operation, and a maintenance service department to repair various pieces of equipment sold to customers. Effective in January of 1998, taxpayer merged into another satellite dish corporation. Further facts will be added as necessary.

I. State Gross Retail Tax—Burden of Proof for Exemptions

DISCUSSION

Taxpayer protests the assessment of state gross retail tax on items for which taxpayer claims to have sold subject to valid exemptions. The auditor reviewed sales invoices for satellite equipment sales for October 1997, stating that this month was closest to the average monthly sales for 1997. At the hearing, taxpayer took issue with the selection, arguing that October, part of taxpayer's fourth quarter sales, was highly inflated due to an increase in purchases of high-ticket items in anticipation of the holidays. While there is a projection agreement form in the file, it was not signed by taxpayer's representative. The auditor indicates that the taxpayer's representative at the time of the audit was aware that the sales invoices for October 1997 would be used as the time frame for projecting taxpayer's 1997's gross retail tax liability. Taxpayer argued at the hearing that to use the company's most productive month as the basis for the projection was unjust. However, there is nothing in the statutes or regulations circumscribing an auditor's choice of time frames for projecting results.

Taxpayer's major argument is that the Department did not give taxpayer credit on all certificates and affidavits sent to the auditor as proof that taxpayer was selling satellite dishes to purchasers for resale. In as much as some of taxpayer's out-of-state customers, who are not registered to do business in Indiana, are within a short enough driving distance to a distribution center that they prefer driving for pick-up rather than paying shipping charges, a brief examination of the applicable statutes and regulations is in order.

Under IC § 6-8.1-5-1(b), a "notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made. IC § 6-2.5-2-1 imposes an "excise tax, known as the state gross retail tax... on retail transactions made in Indiana." Second, IC § 6-2.5-3-2 also imposes an excise tax, "known as the use tax," "on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction." *See also*, 45 IAC 2.2-2-1, 45 IAC 2.2-2-2, and 45 IAC 2.2-3-4, regulations defining terms in the statute imposing the state gross retail tax, and setting forth the retail merchant's duty to collect the tax.

The above statutes and regulations clearly state that tax is assessed and the retail merchant collects and remits the tax to the State of Indiana *unless* the retail merchant—taxpayer—supplies proof sufficient to either avoid the liability in the first instance, or defend against the liability during an audit.

45 IAC 2.2-8-2 states that "a retail merchant may not make a retail transaction in Indiana" without a retail merchant's certificate. Out-of-state merchants "*may* register with the Indiana Department of Revenue to collect and remit Indiana *use* tax on sales to Indiana purchasers." (Emphasis added). This regulation applies to use tax, not the state's gross retail tax, and applies to sales from outside Indiana to customers within Indiana. This regulation does not apply to out-of-state merchants buying products in Indiana to sell to their own customers in their own states.

For example: a Kentucky retail merchant orders satellite dishes from taxpayer, and taxpayer, instead of shipping the items, makes them available for pick-up at the Kentucky merchant's request. When an out of state customer comes into the state, they are no longer from out of state; they are no longer a retail merchant, but a customer. But for the Kentucky merchant's desire to avoid shipping charges, these types of sales would fall into the category of interstate commerce and would therefore be exempt pursuant to 45 IAC 2.2-8-12(e). However, when the taxpayer acquires physical possession and title to goods in Indiana, this is fully an Indiana transaction. Absent valid Indiana exemption certificates from these customers, taxpayer must establish that these sales were indeed exempt purchases.

FINDING

Taxpayer's protest concerning state gross retail taxes assessed for sales where taxpayer's proof consists of affidavits and out-of-state exemption certificates is sustained to the extent the Audit Division can determine exempt transactions from the affidavits and information contained in out of state exemption certificates.

II. Tax Administration—Penalty

DISCUSSION

Taxpayer protests the imposition of the 10% negligence penalty. Taxpayer argues that its failure to pay the appropriate amount of tax due was based solely on taxpayer's interpretation of the relevant statutes, regulations, and case law.

Indiana Code Section 6-8.1-10-2.1(d) states that if a taxpayer subject to the negligence penalty imposed under this section can show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty. Indiana Administrative Code, Title 45, Rule 15, section 11-2 defines negligence as the failure to use reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence results from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by Indiana's tax statutes and administrative regulations.

In order for the Department to waive the negligence penalty, taxpayer must prove that its failure to pay the full amount of tax due was due to reasonable cause. Taxpayer may establish reasonable cause by "demonstrat[ing] that it exercised ordinary business care and prudence in carrying or failing to carry out a duty giving rise to the penalty imposed...." In determining whether reasonable cause existed, the Department may consider the nature of the tax involved, previous judicial precedents, previous department instructions, and previous audits.

In this instance, taxpayer attempted to maintain records of out-of-state purchases, and to substantiate them during the audit procedure. Taxpayer had reasonable cause to believe it had fully complied with Indiana's gross retail tax statutes and regulations.

FINDING

Taxpayer's protest concerning the abatement of the 10% negligence penalty is sustained.

DEPARTMENT OF STATE REVENUE

0220010282P.LOF

LETTER OF FINDINGS NUMBER: 01-0282P
Gross and Adjusted Gross Income Tax
Calendar Years 1992, 1993, 1994, and 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer has an ownership interest in an Indiana domiciled partnership and is a holding company whose sole asset and activity is the partnership interest. Taxpayer failed to file income tax returns. In 1996, the Taxpayer was merged into the parent company.

The auditor found that the taxpayer had distributive shares of partnership income subject to Gross and Adjusted Gross Income in all years of the audit.

Taxpayer filed a penalty protest letter dated October 17, 2001.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed, states it is a Delaware Corporation with a commercial domicile entirely in Illinois, and was a wholly owned subsidiary of its parent company. Taxpayer states that its taxable income was included in the Illinois unitary filing of its parent. The parent is responsible for the state income tax filing of its own tax liability as well as that of its subsidiaries.

It was an unintentional oversight that the income tax filing of the taxpayer was treated as 100% Illinois. Taxpayer requests an abatement of the penalty. Taxpayer further states that it did not intentionally disregard the tax regulations but that the error was merely an oversight as to the proper filing jurisdiction.

45 IAC 15-11-2(b) states, "Negligence, on behalf of the taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

Taxpayer failed to file Indiana tax returns when it consisted of an Indiana domiciled partnership. A nonfiler is subject to a negligence penalty that the department finds proper. Taxpayer has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420020168.LOF

LETTER OF FINDINGS: 02-0168
Indiana Sales and Use Tax
For the Tax Years 1998, 1999, and 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Natural Gas Utility Exemption – Sales and Use Tax.

Authority: IC 6-2.5-2-1(a); IC 6-2.5-4-5(b); IC 6-2.5-4-5(c); IC 6-2.5-4-5(c)(3); Dept. of State Revenue v. Kimball International, Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); 45 IAC 2.2-4-13(e).

Taxpayer argues that its purchase of natural gas should be exempt from the state's gross retail tax because the natural gas is "predominately used" in the production of tangible personal property.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that it is justified in requesting that the Department of Revenue (Department) exercise its discretion to abate the ten-percent negligence penalty assessed at the time of the audit report.

STATEMENT OF FACTS

Taxpayer is in the business of manufacturing and selling truck parts. Taxpayer manufacturers truck beds, tailgates, and suspension systems. The Department conducted a sales and use tax audit during which taxpayer's financial and utility consumption records were examined. The audit resulted in the assessment of additional use tax. The taxpayer disagreed with portions of the assessment and submitted a protest to that effect. In that initial protest letter, taxpayer challenged the audit's determination that taxpayer was not entitled to a sales and use tax exemption on the purchase of electricity used in taxpayer's Building Three and Building Four. This first issue was subsequently considered during a field audit. After reviewing the electrical use in Buildings Three and Four, the field audit agreed that "the meters are predominately exempt" and should be "allowed as 100 [percent] exempt rather than the calculations included in the audit." According to that field audit, "This issue should be adjusted in a supplemental audit after the [natural] gas issue is settled in hearing." The remaining portions of taxpayer's protest were discussed during an administrative hearing, and this Letter of Findings follows.

DISCUSSION

I. Natural Gas Utility Exemption – Sales and Use Tax.

Taxpayer maintains that it is entitled to a sales tax exemption on the purchase of natural gas used to heat four of its buildings. Each of the four buildings has a separate natural gas meter, taxpayer uses each of the four buildings for somewhat different purposes, and each of the four buildings will be considered here in turn.

Indiana imposes a gross retail (sales) tax on certain sales made within the state. IC 6-2.5-2-1(a). The tax is not imposed on all transactions but only those which constitute "retail transactions."

Sales of public utilities are specifically designated as "retail transactions." IC 6-2.5-4-5(b) states that, "A power subsidiary or a person engaged as a public utility is a *retail merchant* making a *retail transaction* when the subsidiary or person furnishes or sells electrical energy, natural or artificial gas, water, steam, or steam heating service to a person for commercial or domestic consumption." (*Emphasis added*).

However, the legislature has seen fit to allow a number of specific exemptions. *See* IC 6-2.5-5-1 et seq. The statute, designating utility transactions as "retail sales," refers to one of those exemptions. IC 6-2.5-4-5(c) states:

> Notwithstanding subsection (b), a power subsidiary or a person engaged as a public utility is not a retail merchant making a retail transaction when... (3) the power subsidiary or person sells the services or commodities listed in subsection (b) to a person for use in manufacturing, mining, production, refining, oil extraction, mineral extraction, irrigation, agriculture, or horticulture. However, this exclusion for sales of the services and commodities only applies if the services are consumed as an essential and integral part of an integrated process that produces tangible personal property and those sales are *separately metered* for the excepted uses listed in this subdivision. (*Emphasis added*).

Therefore, if a widget manufacturer purchases electricity to operate its widget stamping machine, it is entitled to claim the sales tax exemption as long as there is a way of directly measuring (i.e. "metering') the electricity used by the particular widget stamper. However, taxpayer does not use its natural gas in a directly measurable way to produce its truck parts. Rather, taxpayer buys natural gas in order to provide heat for the four buildings. Instead, taxpayer relies on the language contained within IC 6-2.5-4-5(c)(3). That language permits a manufacturer of tangible personal property to claim the utility exemption "if those [utility] sales are not separately metered but are predominately used by the purchaser for the excepted uses listed in this subdivision."

Therefore, in order to successfully claim the exemption, taxpayer must demonstrate that the natural gas is "predominately used" to manufacture truck parts.

The Department has defined "predominantly used" as follows: "Where public utility services are sold from a single meter and the services or commodities are utilized for both exempt and nonexempt uses, the entire gross receipts will be subject to tax unless the services or commodities are predominantly used for excepted purposes. Predominant use shall mean that more than fifty percent (50%) of such utility services are consumed for excepted use." 45 IAC 2.2-4-13(e).

Building One:

Taxpayer accepts initial delivery of various grades of steel in Building One. In addition, the steel is cut in this building. According to taxpayer, the heat in this building must be maintained at an optimum temperature in order to assure that the temperature of both the steel and the cutting equipment remains consistent. Taxpayer offered a written statement from its steel supplier recommending that the temperature of the steel be maintained in order to "maintain the physical characteristics and dimensional stability of the steel."

Taxpayer also maintains that heating Building One to a consistent level is necessary because the cutting equipment is computer-controlled, and temperature variations will affect the performance of the cutting equipment. Taxpayer supplied a letter from the manufacturer of the computer-controlled cutting equipment. In that letter, the manufacturer states that, "We recommend the area in which our [computer-controlled equipment] is installed be maintained at a temperature no lower than 50 degrees." The letter goes on to state that, "testing has shown the accuracy of the unit to be outside the operational limits [manufacturer] requires for your specific application."

Taxpayer's argument – so far is it concerns Building One – is that taxpayer is entitled to the utility exemption for the natural gas measured at this building's meter because the natural gas is "predominately used" for an exempt purpose.

Building Two:

Taxpayer transfers the cut steel to Building Two. In that building, the steel is bent and wire-welded. According to taxpayer, both the "bending" and wire-welding are computer-controlled activities. If the temperature is not maintained, the steel cannot be consistently bent to the required specification. In other words, if a piece of steel having a temperature of 50 degrees was bent and a piece of steel having a temperature of 70 degrees was bent by the same automated machinery, the resulting two units of formed steel would be inconsistent. In addition, taxpayer states that the wire-welding process also requires that temperature in Building Two be maintained a constant level. According to taxpayer, variations in temperature would affect the steel's electrical resistance, and the resulting weld would be faulty.

Building Three:

After the steel is bent, formed, and welded, it is moved to Building Three where the partially-finished truck equipment is painted. According to taxpayer, its painting process requires that the temperature in Building Three be maintained at approximately 80 degrees. Taxpayer provided information from its paint supplier specifying that a temperature between 65 and 75 degrees be maintained. According to the paint supplier, "At this temperature range the most favorable paint flow and processing is provided." In addition, the paint supplier states that, "Too low workshop temperatures (under 60F/15C) and high humidity are detrimental to the result." Taxpayer states that if the ambient building temperature is too low, the paint will not "cure" properly.

Taxpayer bolsters its claim to the exemption for Building Three on the ground that the painting process requires that the air in Building Three be constantly exchanged with outside air. In its protest letter, taxpayer states that, "The large amount of gas usage [in Building Three] is required because IDEM requires that the air change every 48 seconds for the health of the employees." In addition, taxpayer offered information from its paint supplier indicating that – in order to properly apply the paint – that, "Fresh air is constantly sucked in from the atmosphere and the used air is exhausted at another point."

The audit report rejected taxpayer's claim that it was entitled to the utility exemption for Building Three. In arriving at that conclusion, the audit report compared gas consumption during June, July, and August with gas consumption during the remainder of the year. Because the Building Three gas consumption during the summer months was extremely low – 2 cubic feet of gas – the audit concluded that taxpayer purchased the natural gas merely for general heating purposes. It is undisputed that the purchase of natural gas simply for the purpose of heating a building – even a building in which manufacturing takes place – is a non-exempt transaction under IC 6-2.5-4-5(b). However, taxpayer counters the audit's conclusion stating that a comparison of the amount of gas consumed in Building Three with the amount of gas consumed in two of its other buildings – in which the inside air is not exchanged with outside air – demonstrates that amount of gas consumed in Building Three is largely attributable to the painting activities which occur in that building. Taxpayer's otherwise unverified analysis concludes that the gas consumption in Building Three is approximately three times the amount consumed in a building having a comparable ceiling height and floor area. According to taxpayer, this comparison purports to demonstrate that approximately 87 percent of the gas used in Building Three is attributable to its exempt manufacturing activities.

Taxpayer adds a third argument stating that the computer-controlled painting equipment requires maintaining a certain temperature in order for the equipment to function properly.

Building Four:

The activities in Building Four are similar to the activities occurring in Building One and Building Two except that smaller items of equipment – such as suspension systems – are assembled in Building Four. In Building Four, taxpayer cuts, bends, and wire-welds steel. Again, computer-controlled fabricating equipment directs these activities. Again, taxpayer asserts that the proper functioning of the computer control devices requires the maintenance of a consistent, minimum temperature.

The Department concludes that taxpayer, under IC 6-2.5-4-5(c)(3), is entitled to the "predominately used" exemption for the natural gas metered for use in Building Three because taxpayer has demonstrated that the natural gas consumed in that particular building is "an essential and integral part of an integrated process that produces tangible personal property." Dept. of State Revenue v. Kimball International, Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). In Kimball, given the size of the size of the objects being painted, the manufacturer was able to limit its exempt painting activities within the confines of paint (or spray) booths. In this case, taxpayer has demonstrated that Building Three is acting as the taxpayer's own "paint booth." Given the large and unwieldy size of truck components being painted, taxpayer's decision to treat Building Three as an oversize paint booth and to heat and exchange the inside air accordingly, is entirely justifiable. Without natural gas heat and the constant exchange of room air, taxpayer's painting activities would not occur. Id. at 457. Similar to the manufacturer in Kimball, taxpayer has demonstrated that – but for the natural gas consumed in heating Building Three – the painting of taxpayer's truck parts could not and would not occur unless the entire building was heated to the degree and to the extent that it is. As in Kimball, taxpayer has demonstrated that, "from an operational standpoint," without the heating of Building Three – and the natural gas consumed thereby – the taxpayer's painting process would be not be possible. Id.

FINDING

Taxpayer's protest is sustained in part and denied in part. Taxpayer is entitled to the predominate use exemption for natural gas used in Building Three. Taxpayer is denied the predominate use exemption for Buildings One, Two, and Four.

II. Abatement of the Ten-Percent Negligence Penalty.

In its protest letter, taxpayer stated that it was entitled to abatement of the ten-percent negligence penalty on the ground that it "did not willfully disregard the law," that "[t]he omissions were due to error," and a "deficiency of.05% is hardly material."

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

The audit concluded that the ten-percent negligence penalty was appropriate because taxpayer substantially underpaid use tax in 1998 and 1999 and paid no use tax during 2000. Although – as taxpayer contends – the amount of the additional assessment may have been "negligible," the failure to calculate, self-assess, and pay the accrued use tax does not demonstrate the "ordinary business care and prudence" sufficient to warrant abating the penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420020169.LOF

LETTER OF FINDINGS NUMBER: 02-0169
Sales/Use Tax
For the Years 1998-2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax- Tanning Beds

Authority: IC 6-8.1-5-1 (b), IC 6-2.5-2-1, IC 6-2.5-3-2.

The taxpayer protests the assessment of use tax on certain tanning beds.

II. Sales and Use Tax-Sign

Authority: IC 6-2.5-3-2, IC 6-8.1-5-1 (b).

The taxpayer protests the tax assessed on a sign.

III. Sales and Use Tax- Miscellaneous Expenditure

Authority: IC 6-2.5-3-2, IC 6-8.1-5-1 (b).

The taxpayer protests the assessment of tax on a miscellaneous expenditure.

STATEMENT OF FACTS

The taxpayer is a tanning salon. After an audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional sales and use tax on the taxpayer. The taxpayer protested several assessments. The issues concerning the sales tax assessments for July 1999, October 2000, November 2000 and December 2000 were resolved prior to hearing. At the telephone hearing, the taxpayer protested three assessments.

I. Sales and Use Tax- Tanning Beds

DISCUSSION

The taxpayer protests the assessment of use tax on two tanning beds listed on page 18 of the audit as Asset #84 and Asset #85. The taxpayer considered this transaction a non-taxable profit sharing contract. The department considered this transaction a purchase subject to the use tax.

The department's auditor examined the documentation surrounding the taxpayer's payment. All tax assessments are presumed to be accurate and the taxpayer bears the burden of proving that any assessment is incorrect. IC 6-8.1-5-1 (b). Although given ample opportunity, the taxpayer did not provide any documentation to substantiate its opinion that the transaction constituted a profit sharing agreement. Therefore, the taxpayer did not sustain its burden of proving that the transaction constituted a profit sharing plan.

Indiana imposes a sales tax on retail transactions made in Indiana. IC 6-2.5-2-1. A complementary use tax is imposed on personal property purchased in a retail transaction and used in Indiana when no sales tax has been paid. IC 6-2.5-3-2. The subject transaction was subject to the use tax.

FINDING

The taxpayer's protest is denied.

II. Sales and Use Tax-Sign

DISCUSSION

In 2000, the taxpayer purchased a sign to advertise its business. No sales tax was collected or remitted on the sale of this sign. Therefore, the department assessed the complementary use tax pursuant to IC 6-2.5-3-2. The taxpayer contends that the payment was actually for a non-taxable intangible "right" to use the sign. The taxpayer did not present any documentation before, during, or after the hearing to substantiate its contention. Therefore, pursuant to IC 6-8.1-5-1 (b), the taxpayer did not sustain its burden to prove that the department made an incorrect assessment.

FINDING

The taxpayer's protest is denied.

III. Sales and Use Tax- Miscellaneous Expenditure

DISCUSSION

The department assessed use tax based upon the November15, 1998 check # 7854 for which no detail was provided pursuant to IC 6-2.5-3-2. The taxpayer contends that this check was written to make a non-taxable payment for a bank loan rather than the taxable purchase and use of tangible personal property. The taxpayer did not offer any evidence to substantiate its contention. Pursuant to IC 6-8.1-5-1 (b) the taxpayer did not sustain its burden of proof that the use tax was improperly imposed.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220020261.LOF

LETTER OF FINDINGS: 02-0261
Indiana Corporate Income Tax
For the Tax Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sale of Wood Products to Out-of-State Customers – Gross Income Tax.

Authority: IC 6-2.1-2-2; IC 6-2.1-3-3; 45 IAC 1-1-119(1)(a); 45 IAC 1-1-119(2)(b).

Taxpayer argues that the Department of Revenue (Department) erred when it concluded that the receipt of money from the sale of wood products to out-of-state customers was subject to gross income tax.

II. Classification & Computational Errors.

Authority: IC 6-8.1-5-1(b).

Taxpayer maintains that the audit erred in categorizing exempt and non-exempt sales of wood products; as a result, the amount of the gross income tax assessment is purportedly incorrect.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty because no reason was ever provided taxpayer for imposition of the penalty.

STATEMENT OF FACTS

Taxpayer is in the business of selling specialized wood products. Taxpayer has both foreign and domestic customers. Some of taxpayer's out-of-state customers place an order for a particular type or grade of wood product, taxpayer chooses which of its products conforms to the customer's requirements, and the item is then shipped to that out-of-state customer. Other out-of-state customers send a representative to taxpayer's Indiana location, the representative selects a particular item of wood, and that particular item is set aside and later delivered to the out-of-state customer by means of common carrier.

The Department conducted an audit of taxpayer's records. The audit concluded that money taxpayer received from certain transactions with out-of-state customers was subject to the state's gross income tax. Taxpayer disagreed, submitted a protest, an administrative hearing was held, and this Letter of Findings results.

FINDINGS

I. Sale of Wood Products to Out-of-State Customers – Gross Income Tax.

Taxpayer maintains that receipts derived from sales made to certain of its out-of-state customers are not subject to the gross income tax. The transactions at issue are those in which an out-of-state customer travels to Indiana, chooses a particular item, arranges for taxpayer to ship that item, and thereafter awaits receipt of the selected wood product at the foreign destination. The audit determined that these transactions were intra-state, and the money received was subject to gross income tax. Taxpayer characterizes these particular transactions as inter-state and the receipts not subject to gross income tax.

Indiana imposes a tax on "the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana." IC 6-2.1-2-2. However, not all income is not subject to the tax. IC 6-2.1-3-3 provides that, "Gross income derived from business conducted in commerce between the state of Indiana and either another state or a foreign country is exempt from gross income tax to the extent the state of Indiana is prohibited from taxing that gross income by the United States Constitution."

Pursuant to IC 6-2.1-3-3, the Department has promulgated rules which distinguish between "nontaxable outshipments" and "taxable outshipments." In particular, taxpayer cites to 45 IAC 1-1-119(1)(a) which defines certain sales as exempt. The regulation – in effect at the time of the subject transactions – states that "nontaxable outshipments" include:

> Sales to nonresidents where the seller, upon receipt of a prior order and as part of the contract, ships the goods from a point within or without Indiana to an out-of-state destination. Such sales are exempt from taxation whether shipment is made by the seller in his own conveyance, by his contract carrier or by common carrier, and whether the shipment is made on bills of lading showing the seller, buyer or a third party as the shipper of record.

In the transactions here at issue, the out-of-state customer sends a representative to taxpayer's location before placing an order. The representative selects a particular item it wishes to purchase. That item is labeled and segregated. Taxpayer and out-of-state customer sign a sales agreement for the item in which the taxpayer is required to ship the item to the customer's location. Taxpayer then sends a bill to the out-of-state customer.

Taxpayer maintains that – for purposes of the gross income tax – these particular transactions are not complete until the out-of-state customer physically takes delivery of the selected item at the customer's out-of-state location. Thus, although the customer's representative has chosen the item it wishes to purchase and has signed an agreement to that effect, the transaction is not complete until the item has traveled to taxpayer's site and has been accepted by the customer. In support, taxpayer points out that under basic principles of commercial law, the customer – under certain circumstances – is entitled to refuse delivery of the item and require taxpayer to accept return of that item. Taxpayer asserts that the audit's conclusion "mischaracterizes the facts and mistakes principles of commercial law."

However, the question raised is not one of commercial law or whether or not the out-of-state customer may or may not justifiably renege on the deal it struck with taxpayer in Indiana. For purposes of determining the applicability of the gross income tax, the regulation is squarely on point. 45 IAC 1-1-119(2)(b) states that taxable outshipments include "Sales to nonresidents where the goods are accepted by the buyer or he takes actual delivery within the state. Sales will also be taxable if the goods are shipped out of state on bills of lading showing the seller, buyer or a third party as shipper if the goods were *inspected and accepted*, or when any other evidence shows that the sales were completed prior to shipment in interstate commerce." (*Emphasis added*).

Presumably the out-of-state customer could – justifiably or unjustifiably – eventually refuse to accept delivery of the item. The out-of-state customer could determine that the item shipped was not identical to the item chosen in Indiana; the customer could determine that the item was damaged in transit; the customer could determine it no longer had a need for the item; the customer could simply arbitrarily decide it no longer wanted the item, decline acceptance, and refuse to pay the bill. All of these possibilities raise various questions of commercial, contract, and insurance law, but all of these consequent legal issues are irrelevant to the gross income tax question. Customer came to Indiana, customer inspected and selected a particular item it wanted to purchase, and customer agreed to purchase that item. The transaction was completed in Indiana, and the proceeds from the transactions are subject to the state's gross income tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Classification & Computational Errors.

Given the conclusion that receipts from "inspection sales" are subject to gross income tax, taxpayer maintains that the audit erred in categorizing taxable and nontaxable sales to out-of-state customers. As a result, taxpayer argues that it is entitled to have the Department reexamine the records of its transactions and reclassify a number those transactions.

At the time of the audit, the Department determined the money taxpayer received from "inspection sales" customers was subject to gross income tax. The audit was initially informed that it was not possible to determine which of its transactions were or were not "inspection sales." Subsequently, one of taxpayer's representatives – its export manager – reviewed a listing of all of taxpayer's customers and specified which of the customers did and which did not participate in "inspection sales" of taxpayer's goods. Taxpayer later indicated that this classification was incorrect. Thereafter, taxpayer solicited, received, and supplied "certification letters" from a limited number of its customers indicating that these customers did not – in all cases – enter into "inspection sales." The audit determined that this customer information was inconclusive, one-sided, and did not reasonably or accurately distinguish between those customers which conducted "inspection sales" and those customers which did not. The taxpayer was asked if there was additional information which would assist in distinguishing "inspection sales" customers and "non-inspection sales" customers. Taxpayer responded that that there was no further information which would be of assistance. The audit report was completed based on the information initially supplied by the taxpayer's export manager.

Taxpayer argues that it is entitled to further consideration of the matter. It argues that – upon reexamination of the customers lists – it can now more precisely distinguish between "inspection sales" customers and "non-inspection sales" customers.

The taxpayer was provided with a notice of proposed adjustment indicating that it was liable for additional gross income tax on the money it received from "inspection sales" customers. "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC 6-8.1-5-1(b).

Taxpayer has provided extensive documentation by which it proposes to demonstrate that a number of sales to out-of-state customers were not entered into based upon an in-state inspection and acceptance of the taxpayer's wood products. However, there is nothing in this lengthy documentation which specifically refutes the audit's original determination. Having relied upon the taxpayer's initial information and having been provided with considerable opportunity to refute or supplement that information, it would appear that little can be gained from yet another go-around of the same records available at the time the audit report was prepared. Taxpayer's suggestion that the audit report is flawed does not meet taxpayer's burden of proving the initial assessment is wrong.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Taxpayer's protest was based upon the additional assessment of gross income tax on receipts from sales to out-of-state customers in which the out-of-state customer sent its representatives into the state to inspect and acquire taxpayer's wood products. Taxpayer may have initially been under the impression that these were inter-state transactions and that the receipts were not subject to gross income tax. However, this same issue was addressed during a previous audit, and gross income tax was assessed on virtually identical transactions upon completion of that prior audit. Taxpayer is protesting an issue which had been addressed and resolved during one of its previous state audits. Nonetheless, taxpayer chose not to pay gross income tax on the receipts from similar transactions. Its decision to do so was not indicative of the "reasonable care, caution, or diligence... expected of an ordinary reasonable taxpayer" that would warrant abatement of the ten-percent penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420020303.LOF

LETTER OF FINDINGS NUMBER: 02-0303
Sales and Use Tax
For the Years 1998-2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Sales and Use Tax- Imposition

Authority: IC 6-2.5-2-1, IC 6-2.5.3.2, IC 6-2.5-4-10, IC 6-2.5-3-3, IC 6-2.5-6-1.

The taxpayer protests the assessment of use tax on certain equipment leases.

STATEMENT OF FACTS

The taxpayer was formed as an S corporation on January 1, 1997 to provide medical and chiropractic services to patients. The primary chiropractic service provider had previously provided chiropractic services under another S corporation wholly owned by him. The chiropractor wholly owned the taxpayer in 1997.

To improve his billings and collections, the chiropractor was advised by an outside consulting firm to provide his services in conjunction with a medical doctor. Following the consultant's recommendation, the chiropractor transferred the stock in the corporation to a medical doctor at the beginning of 1998.

The medical doctor performed services for the corporation on a very limited basis and was compensated on an hourly basis for those limited services. He was not given a set salary, nor did he participate in any management activities of the corporation. Instead, whatever income that was generated by the corporation was paid to the chiropractor.

For business planning purposes, the chiropractor formed a second wholly owned corporation. The second corporation owned primarily all of the equipment required to provide chiropractic services to the chiropractor's patients. An equipment lease was entered into between the taxpayer and the second corporation beginning in 1998. The taxpayer agreed to lease the equipment for $3,500 per month or $42,000 per year even though the actual cost of the equipment approximated only $70,000. Sales tax was paid on the acquisition of this equipment. The rental amount was accrued on each company's books at $42,000 per year, or $168,000 for the four years in question, but no rent was ever paid by the taxpayer to the second corporation.

Both the taxpayer and the second corporation were cash basis taxpayers for income tax purposes. The taxpayer never recognized any equipment lease expense for tax reporting purposes. The second corporation never recognized any equipment lease income for tax reporting purposes. The equipment lease agreement stated that the taxpayer was responsible as the lessee for all required taxes such as sales or use taxes. No sales or use taxes were ever paid with respect to the lease because no rent was ever actually paid in cash.

As of December 31, 2001, the taxpayer had accrued an equipment lease payable to the second corporation of $168,000 for book, not tax, reporting purposes. The second corporation had a corresponding equipment lease receivable on its books. On

December 31, 2001, the chiropractor purchased 100 % of the stock of the taxpayer from the medical doctor. A moment after the ownership changed hands, the taxpayer entered into a plan of merger with the second corporation and two other corporations owned by the chiropractor. The taxpayer became the surviving corporation. As a result of these actions, the equipment lease receivable and payable were cancelled, without any funds changing hands, and these accrued entries were removed from the books of the newly merged entity. The chiropractor resumed his prior method of doing business and just charged for chiropractic services without any medical doctor referrals.

In an audit for the years 1998-2001, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed use tax on the equipment. The taxpayer protested the imposition of the use tax and a hearing was held.

I. Sales and Use Tax- Imposition

DISCUSSION

Indiana imposes a sales tax on retail transactions made in Indiana. IC 6-2.5-2-1. A complementary use tax is imposed on personal property purchased in a retail transaction and used in Indiana when no sales tax has been paid. IC 6-2.5-3-2. For the purposes of the sales and use tax, retail transactions include lease transactions. IC 6-2.5-4-10. The amount of the use tax is measured by the gross retail income received. IC 6-2.5-3-3.

The taxpayer agrees that the situation was set up as a lease transaction subject to the sales and use taxes. Pursuant to the lease agreement submitted at the hearing, the taxpayer was to pay any state retail taxes imposed on the taxpayer's use or the other corporation's acquisition of the leased equipment. Therefore, as the corporations were set up and pursuant to the signed lease, the taxpayer should have reported and remitted use tax on the use of the leased equipment each month as required by IC 6-2.5-6-1.

The taxpayer argues that since it never actually collected any money, it never had any actual gross income from the leases to measure the amount of use tax due to the state. The taxpayer errs in this conclusion. The taxpayer observed the formalities of a lease in every respect but one. The fact that the taxpayer failed to make any lease payments does not abrogate the existence of a lease, which is a retail transaction. The taxpayer's assertion that it was a cash basis taxpayer is contradicted by the fact that it recorded the lease amounts in accounts payable. It is not relevant that the lessor did not insist on payment.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

1820020305.LOF

LETTER OF FINDINGS: 02-0305
Financial Institutions Tax
For the Tax Years 1995 through 2000

NOTICE: Under 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Constitutionality of the Financial Institutions Tax.

Authority: Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); IC 6-5.5-1-12, 13; IC 6-5.5-1-17(a); IC 6-5.5-2-1(a); IC 6-5.5-2-2; IC 6-5.5-2-3; IC 6-5.5-3-1(6); 45 IAC 17-3-5(a).

Taxpayer argues that because it is an out-of-state entity having only minimal contacts with Indiana, the imposition of the Financial Institutions Tax (FIT) violates the Commerce Clause.

II. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer maintains that its failure to file FIT returns was not due to negligence and that it is entitled to request an abatement of the ten-percent negligence penalty imposed at the conclusion of the audit examination.

STATEMENT OF FACTS

Taxpayer and its subsidiaries (hereinafter collectively "taxpayer") are financial institutions. Taxpayer is incorporated in a state outside Indiana and maintains its commercial domicile in another state outside Indiana. Taxpayer earns money from Indiana customers by issuing credit cards, collecting interest on charges made to those cards, and by financing the purchase of automobiles.

The Department of Revenue (Department) conducted an audit review of taxpayer's various business operations and determined that it came within the purview of the state's Financial Institutions Tax (FIT). Taxpayer had not filed a FIT return for any of the years considered during the audit review.

The Department concluded that taxpayer owed FIT taxes during the years 1995 through 2000. A proposed assessment of those taxes was issued to the taxpayer. In response, taxpayer challenged the assessment, an administrative hearing was held during which taxpayer explained the grounds for its protest, and this Letter of Findings results.

DISCUSSION

I. Constitutionality of the Financial Institutions Tax.

Four of taxpayer's business divisions were included in the proposed FIT assessment. Taxpayer maintains that three of those divisions do not have "nexus" with Indiana and that the assessment rendered against those three divisions was inappropriate. The fourth division – the car finance company – maintained a salesman within this state. The salesman's job was to encourage Indiana car dealerships to offer the car finance company's services to individual car customers. However, taxpayer argues that this fourth division is also not subject to the state's FIT because the 'salesman's activity in the state was restricted to mere solicitation of customers."

For all four of its business divisions, taxpayer's argument is that its contact with Indiana is so attenuated that imposition of FIT violates the Commerce Clause (U.S. Const. art. I, § 8).

Within Indiana, "There is imposed on each taxpayer a franchise tax measured by the taxpayer's adjusted gross income or apportioned income for the privilege of exercising its franchise or the corporate privilege of transacting the business of a financial institution in Indiana." IC 6-5.5-2-1(a).

For purposes of the FIT, a "'[t]axpayer' means a corporation that is transacting the business of a financial institution, including any of the following:

(1) A holding company.
(2) A regulated financial corporation.
(3) A subsidiary of a holding company or regulated financial corporation.
(4) Any other corporation organized under the laws of the United States, this state, another taxing jurisdiction, or a foreign government that is carrying on the business of a financial institution." IC 6-5.5-1-17(a).

The FIT is imposed on both "nonresident taxpayers" and "resident taxpayers" transacting business within this state. IC 6-5.5-1-12, 13. The statute defines a "nonresident taxpayer" as "a taxpayer that (1) is transacting business within Indiana as provided in IC 6-5.5-3; and (2) has its commercial domicile outside Indiana." A resident taxpayer, not filing a combined return, determines its FIT liability based on the resident taxpayer's adjusted gross income from whatever source derived. IC 6-5.5-2-2. In contrast, a nonresident taxpayer determines its FIT liability based on its apportioned income consisting of the taxpayer's adjusted gross income "multiplied by the quotient of (1) the taxpayer's total receipts attributable to transacting business in Indiana... divided by (2) the taxpayer's total receipts from transacting business in all jurisdictions...." IC 6-5.5-2-3.

The FIT definition of "transacting business" within this state includes the activities of a company which "regularly engages in transactions with customers in Indiana that involve intangible property, including loans... [that] result in receipts flowing to the taxpayer from within Indiana." IC 6-5.5-3-1(6).

Taxpayer challenges the FIT assessment on the ground that it does not have a substantial nexus with Indiana. In Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977), the Supreme Court stated that a tax will not be deemed to interfere with interstate commerce when it is "applied to an activity with a substantial nexus within the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state." Id. at 279. Taxpayer's protest is based on the assertion that it does not have the minimum connection with the state necessary to establish the requisite "substantial nexus."

To the extent taxpayer maintains that Indiana's FIT is – on its face – inapplicable, the Department must disagree. Under IC 6-5.5-3-1, IC 6-5.5-1-12, and IC 6-5.5-1-17, taxpayer falls squarely within the definition of a non-resident entity conducting the business of a financial institution within this state; consequently, taxpayer is liable for FIT on the income derived from sources within Indiana. Because the four divisions are part of a "unitary business," the audit correctly determined that taxpayer was required to "file a combined return covering all the operations of the unitary business...." 45 IAC 17-3-5(a).

To the extent taxpayer facially challenges the constitutionality of the FIT as applied to non-resident businesses having only an economic nexus with Indiana, the Department declines to address the question raised.

FINDING

Taxpayer's protest is respectfully denied.

II. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer requests that the Department exercise its discretion to abate the ten-percent negligence penalty.

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...."

Taxpayer did not file FIT tax returns, was audited during 2002, and was assessed for six years of unpaid taxes. Taxpayer is a substantial, sophisticated business receiving large amounts of money from sources within Indiana. Taxpayer's larger constitutional question aside, the decision to ignore its actual or potential liability under the state's FIT is not the evidence of the "ordinary business care and prudence" expected of an "ordinary reasonable taxpayer" that would warrant abatement of the ten-percent negligence penalty.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0420020319.LOF

LETTER OF FINDINGS: 02-0319
Gross Retail Tax
For the Years 1991 through 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Taxpayer Acting in an Agency Capacity – Gross Retail Tax.

Authority: IC 6-2.5-1-2; IC 6-2.5-1-8; IC 6-2.5-2-1(a); IC 6-2.5-4-10(a); 45 IAC 2.2-4-27(c); Black's Law Dictionary (7th ed. 1999).

Taxpayer argues that it was not required to collect gross retail (sales) tax on the price it charged its customers when the customers acquired copies of tax survey maps because taxpayer was merely acting as an agent for the county which retained ownership of the original map information.

II. Land Survey Maps as Tangible Personal Property – Gross Retail Tax.

Authority: IC 6-2.5-1-1; IC 6-2.5-1-2; 45 IAC 2.2-4-1.

Taxpayer maintains that because the land survey maps did not constitute tangible personal property, taxpayer was not required to collect sales tax on the price it charged its customers to acquire the maps.

STATEMENT OF FACTS

Taxpayer is in the mapmaking business. Taxpayer developed land survey maps for an Indiana county. In turn, taxpayer entered into a "marketing agreement" with that county allowing taxpayer to "lease" collections of the land survey maps to the public. In exchange for the right to transfer this proprietary information, taxpayer paid the county a royalty fee for each set of maps transferred. Taxpayer's customers included governmental entities, libraries, realtors, land developers, attorneys, and other commercial enterprises. In acquiring these map compilations, each customer signed a "lease agreement" in which the customer agreed to not to copy the map information and to return to taxpayer the compilation after twelve months.

The Department of Revenue (Department) conducted an audit of taxpayer's business records. The Department decided that taxpayer should have been collecting sales tax on the price it charged individual customers for the right to use the map compilations. The Department sent taxpayer notices of "Proposed Assessment." Taxpayer disagreed with the basis for the assessments, submitted a protest to that effect, an administrative hearing was held in which taxpayer explained the basis for its protest, and this Letter of Findings results.

DISCUSSION

I. Taxpayer Acting in an Agency Capacity – Sales Tax.

Taxpayer argues that the money it received from transferring land survey books to individual customers was not subject to sales tax because taxpayer was merely acting as an agent for the county which retained control and ownership of the map information. According to taxpayer, the county "retains its ownership [of the maps] and the information contained therein." Taxpayer's argument is that it is merely providing a service on behalf of the county, and the money it receives is not subject to sales tax.

Each time a customer acquires a land survey book from taxpayer, the customer signs a "Lease Agreement." In that agreement, taxpayer is referred to as the "lessor." The customer is called the "lessee." The object of the transaction – the land survey book – is referred to as the "edition," the "volume," and the "items delivered." In signing the agreement, the customer (lessee) agrees to pay a fixed "rental fee."

In Indiana, "An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana." IC 6-2.5-2-1(a). The state requires that all "retail merchants" collect the sales tax on "retail transactions" that occur within the state. IC 6-2.5-1-2; IC 6-2.5-1-8.

The gross retail tax is also applicable to certain lease and rental transactions. IC 6-2.5-4-10(a) states that "A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person."

The regulation helps explain the statute. 45 IAC 2.2-4-27(c) states as follows:

In general, the gross receipts from renting or leasing tangible personal property are subject to tax. The rental or leasing of tangible personal property constitutes a retail transaction, and every lessor is a retail merchant with respect to such transactions. The lessor must collect and remit the gross retail tax or use tax on the amount of actual receipts as agents for the state of Indiana. The tax is borne by the lessee, except when the lessee is otherwise exempt from taxation.

It would appear from the face of the parties' agreement, that the object of each particular transaction is the transfer – albeit temporary – of a land survey book from taxpayer to the customer. In consideration for that transfer, the customer pays taxpayer a rental fee. Taxpayer's expertise may be in the assembling of information and the preparation of maps, but in the transactions here at issue, the customer is not buying taxpayer's services – the customer is renting a book of maps. The character and nature of its "Lease Agreement" brings these transactions within the purview of the state's gross retail tax. Taxpayer – in providing the land survey books – is acting as a "retail merchant" entering into "retail transactions" when it collects money from its customers in exchange for the right to possess and use the books for twelve months. The fact that each customer is obligated to return the land survey books after one year is irrelevant; such a stipulation is inherent in the nature of any rental or lease arrangement.

Taxpayer's agency argument is somewhat underdeveloped. Presumably, taxpayer maintains that it is merely acting as an agent for the county when it collects the rental fees. However, there is no indication that taxpayer and the county ever intended to enter into such a relationship. The agreement between the taxpayer and the county simply states that "[taxpayer] will pay [county] a royalty fee of ten percent (10%) of the commercial sale price on all commercial sales made by [taxpayer] from the County's tax map master and aerial photos." In contrast, an agency agreement is characterized as a "fiduciary relationship created by express or implied contract or by law in which one party (the *agent*) may act on behalf of another party (the *principal*) and bind that other party by words or actions." Black's Law Dictionary 62 (7th ed. 1999) (*Emphasis in original*). The agreement between taxpayer and the county is not an agency agreement because taxpayer is not authorized to act on behalf of the county, taxpayer is not authorized to bind the county, and the county is not made responsible for the acts of the taxpayer. Instead, the agreement is simply a royalty contract which requires taxpayer to pay the county a set portion of the money taxpayer receives for leasing the land survey books.

Taxpayer is a retail merchant receiving money from leasing land survey books. The audit was correct in determining that taxpayer should have been collecting sales tax from its customers.

FINDING

Taxpayer's protest is respectfully denied.

II. Land Survey Maps as Tangible Personal Property – Sales Tax.

Taxpayer challenges the assessment on the ground that it was not leasing "tangible personal property," but it was merely providing services to its customers. Taxpayer supports that argument by pointing out that it could have delivered this same intangible information to customers by other means than providing customers with a book of paper maps. For example, taxpayer states that this information could have been provided by means of a fax machine or that the information could have been distributed over the internet.

The preparation of the land survey books is – of course – heavily dependent on taxpayer's skill and expertise in assembling and compiling information into a tangible form. The land survey books are themselves simply an assemblage of paper, ink, and bindings. However, when taxpayer rents the land survey books to a customer, it is entering into a "unitary transaction" under 45 IAC 2.2-4-1. The regulation states as follows:

(a) Where ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a "retail merchant."

(b) All elements of consideration are included in gross retail income subject to tax. Elements of consideration include, but are not limited to:

(1) The price arrived at between purchaser and seller.

(2) Any additional bona fide charges added to or included in such price for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other services performed in respect to or labor charges for work done with respect to such property prior to transfer.

(3) No deduction from gross receipts is permitted for services performed or work done on behalf of the seller prior to the transfer of such property at retail.

The regulation derives from IC 6-2.5-1-1 which states that a "'unitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." A "retail unitary transaction" occurs when a retail merchant purchases tangible personal property in his ordinary course of business and then sells that property along with services as a unitary transaction. IC 6-2.5-1-2.

The object of the lease transaction is the temporary transfer of a land survey book from taxpayer to customer. Although taxpayer's services were necessary to initially assemble and prepare the book, the customer is not leasing taxpayer's services; the customer is merely leasing the book for a fixed price for a fixed term. Taxpayer's lease of its land survey books is analogous to the consumer rental of a video tape. In the same way that a video store is responsible for collecting sales tax on each rental of a DVD or video tape, taxpayer is responsible for collecting sales tax each time it leases one of its land survey books. Although the originator of both the DVD and the land survey books may have expended considerable effort (services) in preparing both items, nonetheless, the subsequent rental of both the DVD and the land survey book is subject to the sales tax.

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

0320020522P.LOF

LETTER OF FINDINGS NUMBER: 02-0522P
Withholding Tax
For December 31, 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer filed its DB020W-NR and payment late and was assessed a late payment penalty. In a letter dated June 14, 2002, taxpayer protests the penalty assessed because it had "paid an extension payment for 2001 for composite tax of $8,000 on April 15, 2002" and subsequently realized the extension payment was actually due on March 15, 2002. Taxpayer states that it estimated the composite tax for 2001 to be $8,000, however, since the 2001 Form IT-65 had not been prepared (on extension until October 15, 2002), the taxpayer did not know the exact amount of tax due for 2001. Taxpayer requests a penalty waiver because it should not have been issued a notice for late payment of the extension until the actual tax was determined.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was assessed a ten percent (10%) late payment penalty because it paid its tax after the due date of the return.

Taxpayer argues that it remitted $8,000 in withholding taxes and found that the tax was actually less when it filed its IT-65 return. The total composite tax on Schedule IT-65COMP was less than the $8,000 remitted.

Form DB020W-NR is used when a taxpayer has not established a separate nonresident withholding account to remit Indiana state income tax withholding on annual income distributions to nonresident shareholders. If an entity pays or credits amounts to its nonresident shareholders, partners or beneficiaries on time each year, the withholding payment is due on or before the fifteenth day of the third month after the end of the taxable year; i.e. March 15. It is noted that this form establishes a separate nonresident withholding account.

Form WH-3 (annual withholding reconciliation and transmittal form) and state copies of Form WH-18 (Indiana miscellaneous withholding tax statement) must be filed annually on or before February 28. The Department permits an entity paying or crediting amounts to its nonresidents only one time each year, an extension of time to file Form WH-3 until March 15. However, the payment of withholding tax on the one time annual distribution is required to have been remitted (and the withholding statement provided to the payee) 2 ½ months after the end of the entity's taxable year. An extension of time to file Form WH-3 may be requested if the information on the distributive share of income reportable on Form WH-18 is not available by the due date. However, an extension of time to file Form WH-3 does not extend the time to pay withholding tax due on Form DB020W-NR. Taxpayer has not submitted the WH-3 or WH-18 forms to date.

Taxpayer states that it estimated the composite tax for 2001 to be $8,000, however, since the 2001 Form IT-65, Indiana Partnership Return, has not been prepared (on extension until October 15, 2002), the taxpayer does not know the exact amount of tax due for 2001.

DBO20W-NR is not an estimated payment voucher but a tax return. The tax return is used to report withholding on annual income distributions to nonresident shareholders and is due no later than March 15. The payment in the amount of $8000 was clearly late.

The taxpayer credited the $8,000 on its IT-65 (Indiana Partnership Return) which resulted in a refund because it overpaid its DB020W-NR account. Any payment made after the original due date must include penalty and interest because the filing due date for the partnership return is different than the payment due date of the income tax withholding and composite adjusted gross income tax on nonresident partners.

Taxpayer has not provided reasonable cause for its late filing and payment.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030045P.LOF

LETTER OF FINDINGS NUMBER: 03-0045P
Gross and Adjusted Gross Income Tax
For Fiscal Years Ended 03/31/99, 03/31/00, and 03/31/01

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was assessed a penalty at audit for failing to report gross income to the state of Indiana
and a penalty for the underpayment of estimated income taxes. Taxpayer protests the proposed penalty assessments for the underpayment of estimated taxes and the audit penalty.

I. Tax Administration – Penalties

DISCUSSION

Taxpayer is a general contractor with ongoing contracts in numerous states. The contract that gave rise to the tax assessment was entered into on June 1, 1999, representing taxpayer's initial entrance into the state of Indiana. Taxpayer has no other physical presence in the state of Indiana. Taxpayer protests the penalties assessed for the underpayment of estimated income taxes and the audit penalty.

Taxpayer states that it has an internal Tax department and outsources its income tax compliance to an accounting firm based out of state. Taxpayer states that the gross income tax was inadvertently overlooked and to further exacerbate this problem, its outside accounting firm encountered an input error with its software that was made in the initial Indiana income tax return in a year when there were no gross receipts (1999). This error carried forward to subsequent filings and suppressed the computation of the Indiana gross income tax when it should not have been suppressed.

Taxpayer failed to report gross income subject to tax and has not provided reasonable cause to allow a penalty waiver. Taxpayer also failed to pay estimated income taxes. To avoid the penalty, the quarterly estimated payments must equal at least twenty percent (20%) of the total income tax liability for the current taxable year or twenty-five percent (25%) of the final income tax liability for the prior taxable year. Taxpayer failed to make the quarterly estimated payments and has not provided reasonable cause to allow a penalty waiver. Procedures should have been in effect to assure that taxes were timely paid.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030156P.LOF

LETTER OF FINDINGS NUMBER: 03-0156P
Use Tax
Calendar Years 1998, 1999, 2000, and 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a national specialty retailer and cataloger of women's and children's apparel, accessories, and shoes. At audit, it was determined that the taxpayer failed to self assess and remit use tax for operating expense items such as form tabs, display hangers, hangers, masks, cleaning items, shipping records, envelopes, and other miscellaneous items.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that the tax due represents manual errors or incorrect interpretation of Indiana sales tax requirements with respect to selling versus non-selling expenses. Taxpayer states that records will indicate a consistent pattern of timely and accurate filings of its sales tax returns and requests that the penalty be waived.

45 IAC 15-11-2(b) states, "Negligence, on behalf of the taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The taxpayer failed to self-assess and remit tax on 18.67%, 14.22%, 19.88%, and 03.05% (calendar years 1998, 1999, 2000, and 2001 respectively) of its untaxed taxable purchases and has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220030162P.LOF

LETTER OF FINDINGS NUMBER: 03-0162P
Gross Income Tax
For Calendar Year 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalties assessed.

STATEMENT OF FACTS

Taxpayer was assessed a penalty for failing to remit its tax by the due date of the return. Taxpayer protested the proposed penalty assessment in a letter dated April 7, 2003.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the penalty assessed and states that it satisfied the conditions under IC 6-8.1-10-2.1(e). Taxpayer believes it also satisfied the more complicated test that at least 90% of the tax reasonably expected to be due was paid by the original due date. Taxpayer states that it is a partner in a partnership that generated losses since inception. Additionally, gross receipts earned by the partnership are interstate receipts not subject to the Indiana Gross Receipts Tax. However, the partnership sold some of its assets, which were located in Indiana, the sale of which was an unusual, nonrecurring event. Taxpayer states it was not aware of any unusual transaction that had occurred during the year until the K-1 from the partnership was received.

Taxpayer failed to remit its tax by the due date of the return. One hundred percent (100%) of the tax was paid on October 1, 2002, which is clearly late.

Taxpayer should have made itself aware of the tax consequences by the due date of the return. Taxpayer has not provided reasonable cause to allow a penalty waiver.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030168P.LOF

LETTER OF FINDINGS NUMBER: 03-0168P
Use Tax
Calendar Years 1999 and 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a manufacturer. Upon audit it was discovered that the taxpayer failed to remit use tax on clearly taxable items such as office computers, shop supplies, material handling equipment, and other miscellaneous items.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer requests that the penalty assessed be waived because the additional liability was not due to a deliberate or negligent failure on its part to assess tax. Taxpayer states that the omission related to the more complex application of the M&E exemption to various aspects of its manufacturing operations, rather than more easily ascertainable omissions.

45 IAC 15-11-2(b) states, "Negligence, on behalf of the taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The taxpayer failed to self-assess and remit tax on more than fifty percent (50%) of items it should have self-assessed tax upon. Most items in the audit are clearly taxable and taxpayer has not provided reasonable cause to allow the department to waive the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420030169P.LOF

LETTER OF FINDINGS NUMBER: 03-0169P
Sales Tax
Calendar Year 2001

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is a restaurant in Indiana. At audit, it was determined that the taxpayer failed to register and remit sales tax collected.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer requests that the penalty assessed be waived because it has no income with which to pay. Taxpayer states that it can begin making monthly payments of the original tax if the Department can settle the matter for penalty and interest.

45 IAC 15-11-2(b) states, "Negligence, on behalf of the taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The taxpayer failed to register with the Department and failed to remit sales tax collected as required. Taxpayer has not provided reasonable cause to allow the department to waive the penalty and the Department has no authority to waive interest.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990248.SLOF

SUPPLEMENTAL LETTER OF FINDINGS NUMBER 99-0248
Gross Income Tax
For the Years 1995, 1996, 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Gross Income Tax- Gross Receipts

Authority: 26 USC Sec.61 (a), IC 6-2.1-2-2, IC 6-2.1-4-2, 45 IAC 1-1-17, Indiana Department of State Revenue v. Northern Indiana Steel Supply Company, 388 N.E. 2nd 596 (Ind. App.) 1979.

The taxpayer protests the inclusion of certain income in gross receipts.

II. Tax Administration –Abatement of Penalty

Authority: IC 6-8.1-10-2.1, IC 6-8.1-10-2.1(d), 45 IAC 15-11-2(b), 45 IAC 15-11-2(c).

The taxpayer protests the imposition of the negligence penalty.

STATEMENT OF FACTS

The taxpayer owned and operated an Indiana television station. After a routine audit, the Indiana Department of Revenue, hereinafter referred to as the "department," assessed additional income tax. The taxpayer protested the assessment and a hearing was held on the taxpayer's alleged constructive receipt of income and penalty. A Letter of Findings was issued on October 24, 2002 denying the protest. The taxpayer requested a rehearing and the rehearing was granted.

I. Gross Income Tax: Gross Receipts

DISCUSSION

The taxpayer owned and operated an Indiana television station. When the taxpayer agreed to sell an advertisement or commercial, it sent an invoice to the advertising agency involved. That invoice showed the gross cost of the advertisement, the advertising agency commission of fifteen per cent (15%) and the net billing for the commercial. The advertising agent paid the taxpayer by check. The advertisers pay the advertising agency's percentage of the bill directly to the advertising agency. The taxpayer never received a check or other monetary compensation for the advertising agency commission. Due to its accrual accounting method, the taxpayer recorded the total price of the advertisement in its books, with separate entries for the advertising agency commission and the actual cost for the airing of the commercial. The taxpayer reported the entire amount of the income as income on its federal income tax return and deducted the amount of the commissions under "other income." The department imposed gross income tax on the advertising agency commissions. The taxpayer protested this assessment.

IC 6-2.1-2-2 imposes a gross income tax on the gross income or gross receipts of taxpayers domiciled in Indiana. The term "gross receipts" is clarified in the applicable 1988 Regulations at 45 IAC 1-1-17 as follows:

> Gross Income Defined. "Gross income" and "gross receipts" mean the entire amount of gross income received by a taxpayer. This includes all income actually or constructively received, i.e., monies credited to the taxpayer by his creditors, or paid to his creditors on his behalf by a third party.

> Amounts received or credited include not only cash and checks but notes or other property of any value or kind, services of any value or kind and receipts in any form received by or credited to the taxpayer in lieu of cash.
>
> The taxpayer is required to report his entire gross income in order to determine its taxability. From this amount he may take deductions as allowed under the Act.

The taxpayer contends that it never actually or constructively received the money or any other services, receipts in kind or any other type of credit for the advertising agency's fifteen per cent (15%) of the total billing. Therefore, the advertising agency fee did not qualify as gross receipts subject to gross income tax.

In accordance with its accrual accounting method, the taxpayer actually recorded the total amount as a receipt. Clearly, this income was credited to the taxpayer and the taxpayer received the benefits of income in its books and balance sheets. The taxpayer also held both the advertiser and the agency jointly and severally liable for any outstanding bill. The taxpayer's statement that it would forbear from attempting to collect the commission does not negate the fact that based upon the invoice, it has the right to collect the commission. Further, the taxpayer reported the total amount on its federal adjusted gross income tax return as "gross income" and took a deduction for commissions paid to advertising agencies.

For purposes of the federal adjusted gross income tax, "gross income" is defined at 26 USC Sec.61 (a) that states in part:

> Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:
>
> (1) Compensation for services, including fees, commissions, fringe benefits, and similar items...

The taxpayer analyzed the subject income for federal adjusted gross income tax purposes and determined that its gross income included the protested amounts. It is clear that the protested amounts were not actually received, therefore they must have been constructively received. The taxpayer was not subject to federal or state adjusted gross income tax on these constructive receipts because those laws allow a deduction under "business expenses" for commissions.

The definitions of the term "gross income" for both the Indiana gross income tax and the federal and state adjusted gross income tax include "all income" received. It is disingenuous for the taxpayer to argue that "all income" for gross income tax purposes doesn't include income that is included in "all income" for adjusted gross income tax purposes. The credited amounts are either part of "all income" or they aren't. The difference appears to be that the protested income is deductible for adjusted gross income tax purposes and not deductible for gross income tax purposes. That is not a valid method for determining if monies were constructively received.

The taxpayer cites the case <u>Indiana Department of State Revenue v. Northern Indiana Steel Supply Company</u>, 388 N.E. 2nd 596 (Ind. App.) 1979 in support of its contention that the contested receipts did not constitute income subject to the gross income tax. In the cited case, the Northern Indiana Steel Supply Company sold two cranes, magnets, and a mobile office with furniture to another company. The cranes and magnets were subject to liabilities. The negotiated purchase price was $405,319.80. The purchaser satisfied the total purchase price by assuming the liabilities in the amount of $383,163.50 and paid the seller cash in the amount of $22,156.30. The Indiana Department of Revenue attempted to assess gross income tax on the value of the assumption of the liabilities. In holding that only the cash received was subject to the gross income tax, the Court stated at page 599 as follows:

> The taxing statute empowers the Department to tax payment of a taxpayer's debts by a third party *for his direct benefit*. In this case, the purchaser paid the liens for its own direct benefit. The fact that Northern was thereupon freed as surety on the obligations constituted at most an incidental or indirect benefit under the taxing statute.

This case is distinguishable from the taxpayer's situation. The taxpayer does receive direct benefits from this method of accounting for the funds. For example, the taxpayer is still liable for the amounts paid to the advertising agency at the time they are to be paid by the third party.

The advertising agency fees recorded in the taxpayer's books were constructively received gross income since a third party satisfied the taxpayer's obligation to the advertising agency and the taxpayer declared them as such for federal and state adjusted gross income tax purposes. As such, the recorded amounts were gross income as contemplated by the law and regulation. The law provided for certain deductions from gross income for tax purposes such as a deduction for bad debts pursuant to IC 6-2.1-4-2. However, the gross income tax law provides no deduction for commissions.

The department properly imposed gross income tax on the commissions.

FINDING

The taxpayer's protest is denied.

II. Tax Administration: Abatement of Penalty

DISCUSSION

The taxpayer also protests the imposition of the ten percent (10%) negligence penalty pursuant to IC 6-8.1-10-2.1. Negligence is defined at 45 IAC 15-11-2(b) as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." <u>Id.</u>

IC 6-8.1-10-2.1(d) allows the department to waive the penalty upon a showing that the failure to pay the deficiency was based on “reasonable cause and not due to willful neglect.” Departmental regulation 45 IAC 15-11-2 (c) requires that in order to establish “reasonable cause,” the taxpayer must demonstrate that it “exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed...”

The legal issue involved in this protest is a difficult and fact sensitive one. The taxpayer sustained its burden in establishing that it was not negligent in failing to pay the assessed gross income tax.

FINDING

The taxpayer’s protest to the imposition of the penalty is sustained.

DEPARTMENT OF STATE REVENUE
REVENUE RULING #2003-01 ARE
June 11, 2003

Notice: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superceded or deleted by publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department’s official position concerning a specific issue.

ISSUES

Auto Rental Excise Tax – Recreational Vehicles

Authority: IC 6-6-9-7, IC 6-6-9-3, IC 9-13-2-123, IC 9-13-2-105, IC 6-6-9-6, IC 9-13-2-188, IC 9-13-2-150

The taxpayer requests the Department to rule whether or not:

1. Rental travel trailers; and
2. Rental recreational vehicles are subject to auto rental excise tax.

STATEMENT OF FACTS

The taxpayer is in the business of renting travel trailers that are pulled behind vehicles and recreational vehicles that are self-propelled.

DISCUSSION – ISSUE #1

Whether or not rental travel trailers are subject to auto rental excise tax.

IC 6-6-9-7(a) states:

An excise tax, known as the auto rental excise tax, is imposed upon the rental of passenger motor vehicles and trucks in Indiana for periods of less than thirty (30) days.

IC 6-6-9-3 references IC 9-13-2-123(a) for the definition of “passenger motor vehicle”. IC 9-13-2-123(a) provides that a “passenger motor vehicle” means a motor vehicle designed for carrying passengers. IC 9-13-2-105 defines “motor vehicle” as a vehicle that is self-propelled.

IC 6-6-9-6 references IC 9-13-2-188(a) for the definition of “truck”. IC 9-13-2-188(a) provides that a “truck” means a motor vehicle designed, used, or maintained primarily for the transportation of property.

A travel trailer does not fall within the above definitions of a passenger motor vehicle or a truck, therefore, the rental of same is not subject to auto rental excise tax.

RULING – ISSUE #1

The Department rules that travel trailers rented for periods of less than thirty (30) days are not subject to auto rental excise tax.

DISCUSSION – ISSUE #2

Whether or not rental recreational vehicles are subject to auto rental excise tax.

IC 9-13-2-150 defines “recreational vehicle” as a vehicle with or without motive power equipped exclusively for living quarters for persons traveling upon the highways.

As established in Issue #1, IC 9-13-2-123 provides that a “passenger motor vehicle” is a motor vehicle designed for carrying passengers.

Notwithstanding the definition of recreational vehicle, a recreational vehicle with motive power, in fact, is not only a vehicle equipped with living quarters for persons traveling upon the highways, but, is also a motor vehicle designed for carrying passengers, i.e., a passenger motor vehicle.

This being the case, a recreational vehicle with motive power falls within the ambit of IC 6-6-9-7, hence, the rental of same is subject to auto rental excise tax.

RULING – ISSUE #2

The Department rules that recreational vehicles with motive power rented for periods of less than thirty (30) days are subject to auto rental excise tax.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the Taxpayer any protection.